DOMTAR®

Annual Report 1986

the Competitive Edge...

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Domtar is a resource-based multi-business corporation.

Its mission is to:

• serve customer needs world-wide for products manufactured from natural resources in North America;

• focus on selected businesses in forest products, packaging, building and chemical products where the Corporation maintains a leading position and is cost-competitive;

• achieve long-term growth in earnings and share value through internal development and balanced diversification in compatible fields.

Domtar's businesses

Chemicals
Sifto® Salt
Coal tar products
Specialty chemicals
Wood preserving

Construction Materials
Gyproc® gypsum board
Arborite® high-pressure laminates
Cladboard® melamine-surfaced particleboard
Roofing products
Fibreboard
Distribution of Fiberglas(*) insulation in Canada

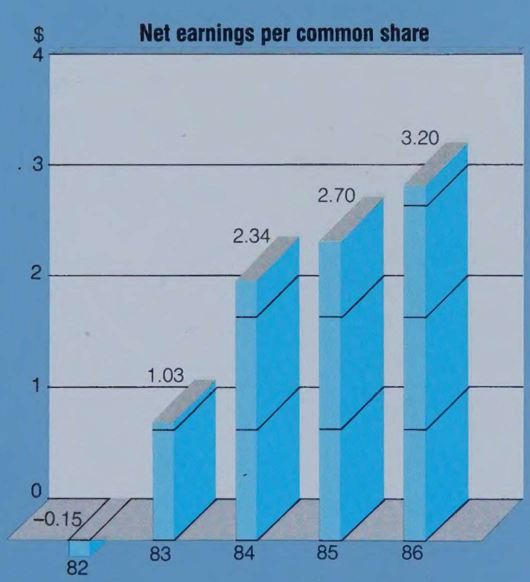
Packaging
Corrugated containers
Corrugating medium and linerboard
Composite cans
Recycled waste paper

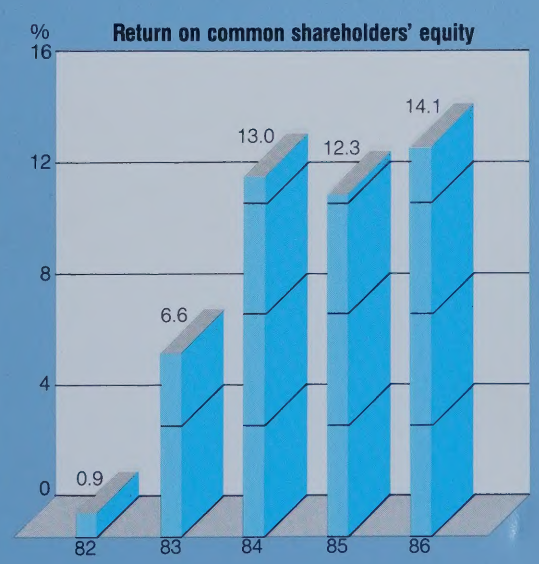
Pulp & Paper Products
Fine papers
Newsprint and groundwood specialty papers
Pulp
Lumber
Forest harvesting and management

Gas & Oil

Highlights

		1986	1985	1984
Operations (millions of dollars)				
	Sales	$2,327	$2,130	$2,044
	Net earnings	145	110	90
	Cash flow from operations	295	205	177
	Capital spending	475	300	160
Per common share				
	Earnings before extraordinary items	$ 2.99	$ 2.33	$ 2.22
	Net earnings	3.20	2.70	2.34
	Cash flow from operations	6.80	5.17	4.70
	Dividends	0.97	0.79	0.60
	Year-end book value	22.71	19.71	17.89
Return on common shareholders' equity		14.1%	12.3%	13.0%
Ratio of long-term debt to shareholders' equity		22:78	24:76	30:70





Domtar Inc. Directors and Officers

Board of Directors

J.A. Gordon Bell (1)
Toronto, Deputy Chairman of the Board, President and Chief Operating Officer, The Bank of Nova Scotia

Gilles Blondeau (1) (2) (4)
Montréal, President and Chief Executive Officer, Optimum Group Inc.

Guy Coulombe (1) (2)
Montréal, President and Chief Executive Officer, Hydro-Québec

Robert Després, O.C. (3)
Québec, Counsel

Jacques A. Drouin (4)
Montréal, Executive Vice-President and Chief Operating Officer, The Laurentian Group Corporation

Margaret L. Hamilton (3)
Toronto, Consultant, Thomson Newspapers Limited

Robert E. Heneault (2)
Toronto, Executive Vice-President, Stelco Inc.

John G. Kirkpatrick, Q.C. (3) (5)
Montréal, Senior Partner in the legal firm of Ogilvy, Renault

Jean-Claude Lebel (1) (2) (5)
Montréal, President and Chief Executive Officer, CGI Enterprises Inc.

Jacques A. Lefebvre (3) (4)
Montréal, President, LaSalle College

John C. Major, Q.C. (4)
Calgary, partner in the legal firm of Bennett Jones

Rémi Marcoux (3)
Montréal, President, Groupe Transcontinental G.T.C. Ltée

Robert Marcus (2)
San Francisco, former President and Chief Executive Officer, Alumax Inc.

Raymond R. Pinard
Montréal, Executive Vice-President and Chief Operating Officer, Domtar Inc.

Yves Pratte, Q.C. (1) (2) (5)
Montréal, Chairman of the Board, Domtar Inc.; partner in the legal firm of Clarkson, Tétrault

James H. Smith (1) (2) (4) (5)
Montréal, President and Chief Executive Officer, Domtar Inc.

Edward J. Waters (4)
New York, Managing Director, Kidder, Peabody & Co. Incorporated

Lorne C. Webster (4)
Montréal, Chairman of the Board and Chief Executive Officer, Prenor Group Ltd.

Member of the:
(1) Executive Committee
(2) Executive Management and Compensation Committee
(3) Audit Committee
(4) Investment Committee
(5) Nominating Committee

Officers

Yves Pratte, Q.C.
Chairman of the Board

James H. Smith
President and Chief Executive Officer

Raymond R. Pinard
Executive Vice-President and Chief Operating Officer

Roger A. Ashby
Vice-President of the Corporation; President, Pulp & Paper Products Group

Steven S. Danyluk
Vice-President, Research and Environmental Technology

Pierre Dupuis
Vice-President of the Corporation; President, Construction Materials Group

G. Andrew Edwards
Assistant Treasurer

Wilfrid L.P. Fournier
Vice-President, Employee Relations

André Gascon
Vice-President and Secretary

W. Boyd Henderson
Vice-President, Engineering

Frederick E. Hertha
Vice-President, Energy

Neil Martin
Vice-President of the Corporation; President, Chemicals Group

Jan A. J. Meyers
Vice-President of the Corporation; Vice-President and General Manager, Fine Papers division

T. Brian Nutter
Controller

Gilles Pharand
Vice-President, General Counsel and Assistant Secretary

Elmer R. Puddington
Vice-President of the Corporation; President, Packaging Group

Derek J. Speirs
Vice-President, Finance and Corporate Development

Halford M. Wilson
Treasurer

Directors' Report

Yves Pratte, Q.C., left, Chairman of the Board, and James H. Smith, President and Chief Executive Officer.

Financial Results

1986 was a good year for Domtar.

Net earnings increased to $145 million from $110 million in 1985. Earnings per share advanced to $3.20 from $2.70, a 19% increase over last year. These results enabled the Corporation to meet its minimum targets for return on assets employed and shareholders' equity.

With sales of $1 billion, the Pulp & Paper Products Group's operating profit increased by 76% in 1986, reflecting improved results in fine papers, pulp and forest products while newsprint and groundwood specialties results remained largely unchanged from a year earlier.

The Construction Materials Group posted an 87% increase in operating profit due principally to a continued strong demand for gypsum board both in Canada and in the United States.

Overall results in the Chemicals Group were marginally lower than in 1985 while the Packaging Group operating profit declined by 38%.

Strategic Actions

The Corporation negotiated the purchase of the gypsum business of Genstar Corporation from Imasco Limited of Montréal for $US 241 million. The acquisition will enhance Domtar's position as a major North American manufacturer of gypsum products. The transaction was finalized in February 1987, following review by U.S. Federal authorities. Domtar took immediate possession of four wallboard plants in New Jersey, Georgia, Texas and Colorado and a paper mill in California. However, the Corporation is required to dispose of the Las Vegas, Nevada facility and related assets within six months.

To strengthen Domtar's position in the North American personal care products markets, the Specialty Chemicals division acquired in December the assets of Miranol Chemical Company, Inc. of Dayton, New Jersey for $US 13 million. Miranol is a leading producer of chemicals used as the basis for industrial, household and health care products.

The Corporation sold its U.S. brick operations. With this sale, Domtar has withdrawn completely from the masonry business, having sold its Canadian operations in 1985.

The rehabilitation of Domtar's fine papers complex in Windsor, Québec is proceeding on target and on budget. More than 60% of the first phase of the project, initiated in April 1985, is now completed. At year-end, close to 1,500 workers were on the site and $482 million had been spent or committed. Assembly of the first paper machine is now two-thirds complete and start-up is scheduled for the Fall of 1987. The second paper machine has been ordered and its start-up is expected early in 1989. Production capacity at the Windsor fine papers complex will be 220,000 short tons by the end of 1987 and will reach 350,000 tons in 1989. The existing 100,000-ton capacity will be phased out.

Conversion of the pulping operation at the Dolbeau, Québec newsprint mill to the chemi-thermomechanical process continued during 1986. The operation, which is scheduled to be completed later this year, will ensure the mill's cost and quality competitiveness in the world's newsprint markets. Further paper quality improvement has been achieved by the installation of top formers on the paper machines at Dolbeau and Donnacona, Québec and Red Rock, Ontario.

At Trenton, Ontario the Packaging Group installed a new 176-inch paper machine to enhance its position as a leading producer of corrugating medium.

To increase production efficiency and capacity, the Corporation undertook modernization programs at its sawmills in White River, Ontario and Mistassini, Québec.

In Amherst, Nova Scotia the Sifto® Salt division completed the upgrading of its salt evaporator plant. This will enable the facility to compete more effectively in the Eastern Canadian and offshore markets.

Dividends

During the second quarter of 1986, the quarterly dividend payment on common shares was raised from $0.22 to $0.25, resulting in an annual dividend of $0.97 per share in 1986, an increase of 23% over 1985.

Financing

In February, Domtar sold $75 million of preferred shares to the public. In July, the Corporation issued a total of 2.5 million common shares, which raised $89 million.

In May, debentureholders approved a number of amendments to the Corporation's Trust Deed. As a result, Domtar obtained covenant relief by, amongst other things, the elimination of an interest coverage test on earnings. This has significantly increased the Corporation's financing flexibility. Later, $102 million of 10.35% debentures maturing in 2006 were issued under a new borrowing indenture.

At year-end Domtar's balance sheet remains strong. With a debt:equity ratio of 22:78 the Corporation is in a good position to secure the financing required for its ongoing investment program.

Labour

Twenty-seven collective agreements, with several in key business areas, were renewed without work disruptions to any of Domtar's operations.

Safety

The Corporation accelerated the implementation of its "Five-Star" Health and Safety Management program. For the fifth consecutive year, Domtar achieved a significant reduction in the frequency of accidents. The severity rate remained the same as in 1985.

Community Affairs

Domtar's corporate donations totalled $770,000 in support of health, welfare, educational and community programs—nationally, regionally and in the locations where Domtar has operations. An additional $380,000 was spent in connection with the Corporation's Young Professionals Program providing "first-time job opportunity".

Employees throughout the organization continued to contribute their own time, skills and enthusiasm to a wide range of community and philanthropic causes.

☐ *Start-up of the first paper machine in the fine papers complex at Windsor, Québec, is scheduled for the Fall of 1987.*

Outlook for 1987

As Domtar is a broadly based natural resource corporation, it is affected by a variety of specific industry environments in both Canada and the United States. In addition, general economic conditions and currency values world-wide have a direct effect on the Corporation's performance.

Overall, real economic growth should continue at about 3% in 1987 reflecting a reasonable level of consumer confidence. Interest rates should decline in the short term, but a continuation of high government deficits could result in increased rates in the longer term. Inflation should remain manageable despite probable increases in energy costs. The weakening of North American currencies in 1986 had a positive impact on Domtar. Even with a strengthening of the Canadian dollar against the United States dollar in 1987, the overall currency advantage gained by Domtar last year is expected to be maintained in 1987.

Industry supply and demand levels should result in further improvements in Domtar's Pulp & Paper, Packaging and Energy Groups. A continued strong performance is expected in the Construction Materials Group and a relative status quo should prevail in the Chemicals Group.

The Corporation will be negotiating 62 labour agreements in 1987, including those for primary mills of the Pulp & Paper and Packaging Groups. The successful renewal of the agreements will have a positive effect on Domtar's income-generating capacity in 1987 and on its ability to preserve jobs and enhance its position as a competitive and reliable supplier.

Domtar is optimistic with respect to achieving an acceptable return on shareholders' equity in 1987.

Changes to the Board of Directors

In March 1986 Messrs. Denis Giroux and Michel Plessis-Bélair resigned from the Board following changes in their responsibilities. Mr. Jacques A. Drouin, Executive Vice-President and Chief Operating Officer, the Laurentian Group Corporation and Mr. Jacques A. Lefebvre, then Executive Vice-President, Société générale de financement du Québec, were appointed to the Board to fill these vacancies.

Mr. John G. Kirkpatrick, Q.C., who has served on the Board since 1954, will not seek re-election, having attained the age limit set for directors. His wise counsel throughout the years and his significant contribution to the deliberations of the Board will be missed.

Freer Trade

Domtar has publicly expressed support of increased trade liberalization with the United States. An open market agreement with appropriate transitional and adjustment measures, permitting flows of goods and services between the two countries, will increase employment, raise living standards and create more productive and competitive economies for both Canada and the United States.

Such an agreement would not endanger Canadian culture or sovereignty since Canada's heritage, as well as its economic destiny, is based on its role as a trading nation. Approximately 80% of Canadian exports are sold to the United States, and millions of Canadian jobs depend on this trade. Increased protectionism on either side of the border will jeopardize existing jobs, whereas enhanced bilateral trade will increase employment for Canadians and Americans alike.

Appreciation

The Directors thank the men and women of Domtar who, through their creativity, enthusiasm and hard work, have contributed significantly to the Corporation's success in 1986.

On behalf of the Board,

Yves Pratte, Q.C.,
Chairman of the Board

James H. Smith,
President and Chief Executive Officer

The Competitive Edge...

Domtar's success is determined by its ability to achieve market leadership in its businesses by providing customers with the best value for the price. To do this, it must secure and retain a distinctive advantage — its competitive edge.

Domtar is dedicated to moving closer to its customers with a higher value-added mix of products, competitively priced, dependably serviced and of constantly improving quality. To achieve this, it is building on the strengths of its businesses, technologies and employees.

A winning marathon runner displays many of the qualities needed by a successful business. Foremost of these are a winning strategy and sustained performance over the long haul.

As the following pages show, Domtar is making solid progress. Substantial capital spending has generated cost reductions and productivity improvements, as have the innovative efforts of Domtar employees everywhere to improve operating methods, products and customer service.

Their successes are evident across the range of Domtar's operations, from effective resource management, product and process improvements to upgrading the marketing function in such key areas as product design and distribution, and the development of dedicated sales personnel.

Increased productivity means more than higher output and lower cost; it is also better quality work. Technology by itself is not a substitute for improved effort: It is a tool to enhance overall performance by creating an environment in which people can improve the quality of their work by responding more effectively to the needs of customers and co-workers alike.

Domtar's competitive edge lies in the judicious blending of its technologies and its people, with its manufacturing and marketing processes so organized as to maximize the efficiency of both in the service of its customers.

hemicals Group

n innovative vapour recompression rocess installed at the Amherst, Nova cotia salt evaporation plant reduces nergy consumption by more than 60% nd improves product quality.

Sifto® Salt

The Goderich, Ontario, and Cote Blanche, Louisiana, mines are strategically located to supply the North American heartland with rock salt for ice control and industrial uses. Both mines are on efficient, low-cost water transportation systems — the Great Lakes and the Mississippi River — while a network of 91 storage depots, warehouses and distribution centres provide an integrated, cost-effective distribution system throughout North America.

The Goderich mine is the second-largest salt operation in the Continent. Its cost-competitiveness has recently been enhanced through a 40% increase in capacity, combined with the introduction of technically-advanced mining technology.

Productivity improvements at the Cote Blanche mine have increased capacity by as much as 80% since 1981 with only modest capital investments.

Domtar also operates across Canada three strategically located plants which produce evaporated salt for a range of water treatment, food processing and household uses. At the Amherst, Nova Scotia facility, manufacturing costs and product quality have improved dramatically following an investment in innovative, energy-efficient technology, applied for the first time in North America. This plant is located to serve the fishery industry and consumer end-uses in Eastern Canada. The other evaporated salt plants are in Goderich and in Unity, Saskatchewan.

2.


☐ *At the Expo 86 site in Vancouver, pressure-treated pilings produced at Domtar's New Westminster plant support precast concrete decking which added 20 acres, or 12%, of valuable waterfront display area to the Exposition. Domtar supplied more than 14,500 pilings, varying from 40 to 75 feet in length.*

Wood Preserving

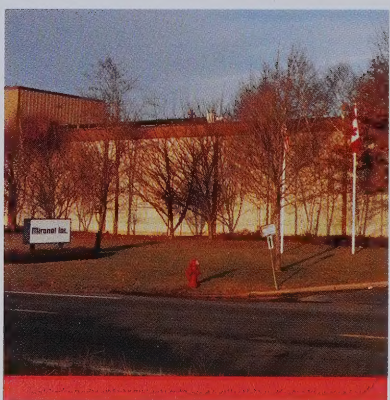
Domtar is Canada's major producer of pressure-treated utility poles and railway ties. Its eight plants, located from coast to coast, serve national and regional customers. National standards of quality control, combined with process expertise, result in exceptionally high quality products. Customers also benefit from Domtar's strong, cost-effective wood supply capability, whether from the Corporation's forested lands or from independent suppliers.

Coal Tar

Distilling most of the coal tar produced in Canada, Domtar is the acknowledged leader in supplying coal tar pitch to Québec's aluminum smelters where it is used as a binder in manufacturing carbon electrodes.

Domtar's coal tar distillation plants in Hamilton and Sault Ste. Marie, Ontario are located beside the major Canadian steel mills which provide their raw materials and are freight-logically close to the Corporation's customer base in Québec. A large and growing segment of the world's aluminum smelting capacity has concentrated in that Province, attracted by competitively-priced and abundant hydro-electrical energy.

To further strengthen its leadership in this large and growing market, Domtar is focussing on product excellence and dependable customer service and is investing in new technology for high-quality coal tar products.



The acquisition of Miranol Chemical Company, Inc., a specialty surfactants manufacturer based in New Jersey, provides an established United States base together with higher value-added product lines and improved market access.

Specialty Chemicals

Domtar is the most integrated Canadian surfactant producer, equipped for a broad range of processes and formulations, principally for use in detergents. As a result, its extensive range of products serves a wide and growing array of customers, while the innovative expertise of its technical personnel enables it to respond swiftly to customer needs, particularly in developing custom formulations and new products. The division has introduced formulations to capture specific opportunities in the toiletries, agricultural and pulp and paper markets. Working closely with Domtar Construction Materials, it has also developed a new foaming agent for gypsum board.

The acquisition in 1986 of Miranol Chemical Company, Inc., a New Jersey-based producer of specialty surfactants for world-wide personal care markets, enhances Domtar's technological expertise, as well as adding higher value-added lines to the product mix and increasing market access both in North America and world-wide.

☐ *Upgrading process facilities at the Hamilton coal tar distillation plant is part of Domtar's strategy for reinforcing its leadership as a supplier to the growing aluminum industry in neighbouring Québec.*

Construction Materials Group

1. *Productivity at the Caledonia, Ontario gypsum products complex has increased following the installation of a new, computerized high-output production line which, with smaller crews, improves output and scheduling flexibility.*

2. *Sales and production employees of Domtar's gypsum operations in the Western U.S. gain expertise in operating a computerized order-processing system, which speeds their response to customer requirements.*

2.

Gypsum Products

Domtar is a leading supplier of gypsum wallboard products across Canada and in the Western and North Central United States. It operates efficient modern plants, fully integrated both with low-cost, high-quality ore reserves and paper-board facilities. Extensive marketing and distribution networks serve all markets within their respective regions.

Incremental investments in Domtar's gypsum facilities have raised their overall capacity by 18% since 1984, while upgrading product quality and improving service to their customer base of national retailers, independent dealers and contractors.

Three strategically located, port-side plants linked to a captive ore supply in Mexico market wallboard products in eight Western states. Incorporating new process technology, the Tacoma, Washington plant entered production in 1982. The two remaining facilities are in Long Beach and the San Francisco Bay area of California.

The five Canadian wallboard plants, together with the Michigan facility, are modern, cost-competitive units, freight-logically situated to serve their regional markets. Due to ongoing process improvements and the immediate proximity of its ore supply, the Caledonia, Ontario complex is the largest and lowest-cost producer in Eastern Canada, serving markets within an 800-kilometre radius, including Eastern Québec and Atlantic Canada.

1.

2.

3.

1. *This contemporary kitchen is made exclusively from Domtar's high-pressure Arborite® and low-pressure Cladboard® laminates. Domtar is a market leader in a product area particularly receptive to design and service expertise.*

2. *Process improvements at the Lloydminster, Alberta roofing plant, which serves Western Canadian markets, are aimed at optimizing the use of high-cost raw materials while enhancing product quality.*

3. *Composite Fibre Plus® roof insulation, developed and introduced by Domtar to meet new market needs, simplifies and speeds the construction of energy-efficient flat roofs.*

Laminated Products

Domtar holds a major share of the Canadian market for both high-pressure melamine-paper laminates (Arborite® products) and low-pressure melamine-particleboard laminates (Cladboard® products).

The products are manufactured at two facilities in Montréal and Toronto, located strategically close to their markets, and at a third in Huntsville, Ontario, adjacent to its wood supply. Employees in the division actively participate in developing productivity improvements. For example, at Huntsville, their suggestions, combined with minor design and process changes, improved the overall plant efficiency by 10%.

Roofing, Fibreboard and Insulation Products

Domtar holds a major share of the Canadian roofing market. Its four cost-competitive plants serve markets across Canada and in the Eastern United States. This market is less cyclical than for most other building products, with re-roofing applications accounting for 60% of sales. Process improvements at the Brantford, Ontario and Lloydminster, Alberta roofing plants, aimed at increasing the efficient utilization of high-cost raw materials, are reducing operating costs.

Under the trademark Fibre Plus®, a new built-up roofing product has been successfully introduced to respond to a growing customer need for simpler, less costly and more thermally efficient systems. Combining the rigidity and dimensional stability of fibreboard with the insulation qualities of polystyrene, the product is being enthusiastically received in the busy construction markets of Ontario and Québec.

Converting the Donnacona, Québec fibreboard plant to natural gas consumption has yielded cost efficiencies.

Domtar is also the leading distributor of Fiberglas(*) home insulation products in Canada, with roughly 35% of the market.

ackaging
roup

2.

Waste paper and boxes recycled by omtar are the primary source of fibre for containerboard mill in Mississauga.

The $35 million modernization of the enton mill included this new paper achine which raises the mill's capacity 85% to 350 tonnes daily.

Containerboard

Domtar is the leading supplier of linerboard and corrugating medium to the Canadian market. Capital investments averaging $29 million annually in the past three years have significantly improved the productivity and competitiveness of its three integrated containerboard mills. Their location in Ontario positions them to serve efficiently the major market.

Productivity at the Trenton corrugating medium mill has already risen by 24% following its modernization in 1985, including the installation of a new paper machine.

Equipment and process improvements at the Mississauga mill have improved its productivity by a yearly average of 6% since its acquisition in 1979. This mill is particularly well-positioned in its markets due to its ability to produce from recycled paper, linerboard or corrugating medium, depending on customer demand. It is also advantageously located within the Metropolitan Toronto market.

The linerboard mill in Red Rock, in Northwestern Ontario, is a modern linerboard mill integrated with a modern and efficient sawmill to ensure cost-effective wood-chip supply.

Recycling

The primary function of Domtar's three paper recycling plants, located in Toronto, Montréal and Buffalo, New York, is to supply secondary fibre to its mills. This material continues to be an important and cost-effective alternative or supplement to virgin fibre in paper manufacture.

Corrugated Containers

Supported by the largest integrated containerboard capacity in Canada, Domtar is a national corrugated container manufacturer, with a major share of the Canadian market. Its 13 plants are well-positioned to serve the country's regional markets and to provide prompt and efficient service to national accounts and local customers alike.

Virtually all Domtar's facilities have undergone substantial modernization during the past three years. Productivity improvements have resulted from upgrading corrugators and installing other high-speed computerized equipment.

Customer service is enhanced through a computer network linking the 13 container plants with a central database containing 18,000 individual box fabricating specifications, including all necessary costing and pricing information.

Customer demand for increasingly sophisticated box designs and graphics has led to the development of microcomputer programs to help design new containers and generate new graphic designs, thereby meeting customers' requirements economically and efficiently.

Wide range of consumer products packaged in Domtar Sonoco composite paper-metal cans includes refrigerated dough.

Domtar Sonoco — Composite Cans

Domtar is Canada's leading manufacturer of composite cans (paper bodies, with metal or plastic ends), in partnership with one of the world's largest suppliers of these products. It is the only domestic supplier of frozen juice concentrate cans sealed with the tear-off Mirastrip(*).

Domtar Sonoco Containers established in 1985 a high-capacity plant in Mississauga in addition to those in Chatham and Prescott, Ontario. This improved its freight-logical position within Eastern Canada and strengthened its competitiveness as a supplier to a range of consumer-product markets including refrigerated dough, snack foods, powdered drinks and frozen concentrates, automotive lubricants, household cleansers and caulking products.

☐ *Packed live in containers fabricated at Domtar's Moncton, New Brunswick plant, lobsters shipped by a Halifax, Nova Scotia customer are in prime condition when they reach food industry buyers throughout North America.*

Pulp & Paper Products Group

High-speed saw head on tree harvest-ing equipment at Lebel-sur-Quévillon cuts the tree cleanly, close to the ground, enabling the sawmill to use more of the available wood.

Forest Products

Domtar's aim is to maximize both the yield of wood fibre per hectare of forest harvested and the cost-effectiveness of its tree-harvesting operations. It achieves this through ongoing mechanization, a process which brings two important benefits — a sharp decline in accident rates and increased wood recovery.

Domtar operates three modern sawmills, in White River, Ontario and at Mistassini and Lebel-sur-Quévillon, Québec. In addition to supplying wood chips to their associated mills, these plants ship random-length lumber and studs for construction use, chiefly in Northeastern and Southern United States markets.

A 13% productivity increase at the White River sawmill will result from a $6 million investment program to improve the quality of logs entering the sawmill and the wood chips supplied to Domtar's containerboard and newsprint mill in Red Rock.

At the same time, an $8 million expansion of the Mistassini sawmill, made necessary by the changing fibre requirements of the newsprint mill in Dolbeau due to its conversion to chemi-thermomechanical pulping, will provide 50% added capacity.

Newsprint and Groundwood Specialty Papers

Domtar is a long-established newsprint supplier to large and small newspapers, principally in the United States. It also supplies a higher value-added product, groundwood specialty papers, to the fast growing publishing and commercial printing markets.

Its manufacturing operations are cost-competitive following the conversion in 1984 of the Donnacona, Québec mill to thermomechanical pulping. Besides improving the quality of the paper, this method is more environmentally protective, makes more efficient use of wood fibre and requires less labour than the chemical and mechanical pulping processes it replaces.

2.

☐ *Productivity improvements at the Lebel-sur-Quévillon pulp mill include the use of this straddle crane to handle logs.*

Construction is more than 50% complete in the $85 million program to convert the pulping operation at the Dolbeau, Québec mill to the chemi-thermomechanical process. When complete in 1987, this project will secure the mill's viability as a cost-competitive supplier to world newsprint markets.

The installation since 1985 of top formers on two of the paper machines in these mills has improved the quality of the paper they produce by significantly enhancing its printability. These competitive benefits particularly support the strategy of developing new, higher value-added products for publishing and commercial printing.

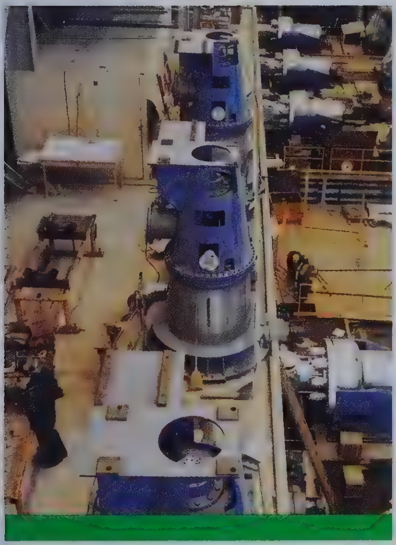
Domtar is the largest fine papers producer in Canada. Its products include more than 500 grades in a range of finishes, weights, colours and sizes for use in business, printing, forms, computers, envelopes, exercise books and cover and text applications.

Pulp

Located in the heart of an ample and economical supply of softwood, the Lebel-sur-Quévillon, Québec pulp mill, with its integrated sawmill, is well positioned to compete successfully in the Eastern North American pulp market.

Domtar sells approximately 60% of its high-density Northern softwood pulp production to other paper manufacturers on world markets through its North American sales offices and overseas agents. The balance is consumed by Domtar's own paper mills.

Ongoing cost reductions and productivity gains in this modern pulp mill are being achieved through increased employee involvement in a series of process improvement programs in key areas.



Construction proceeds on schedule in the $85 million conversion of the Dolbeau newsprint mill to the more cost-competitive chemi-thermomechanical pulping process.

Fine Papers

Domtar is the leading Canadian manufacturer of uncoated fine papers, supplying approximately 30% of the total market. The more than 500 grades it produces in a variety of finishes, weights and sizes provide the widest product range in Canada for printing, writing and converting papers. Of these, photocopy, printing and forms and computer papers alone represent 85% of the total Canadian market and are the products with the strongest market growth.

Domtar is recognized as the lowest-cost Canadian producer. This position is based on its two large mills in Cornwall, Ontario and Windsor, Québec, with their on-site hardwood pulping facilities and competitive wood and energy costs, and on its efficient cut-size sheeting operations.

The relatively small size of the three non-integrated mills in St. Catharines and Toronto, Ontario and Beauharnois, Québec suit them for fabricating lower-volume specialty fine papers.

Domtar also operates one of the country's largest wholesale merchant chains, providing extensive market coverage in Ontario and Eastern Canada.

To better serve its high-growth markets, Domtar undertook in 1985 to establish a world-scale, cost-competitive fine paper mill at Windsor, Québec, with an annual capacity of 350,000 tonnes of uncoated fine papers. Incorporating the most up-to-date technology, the mill will consist of two new high-speed paper machines and a new pulp mill, backed by ample hardwood resources available at competitive cost within 60 kilometres of the mill.

With its first phase scheduled to start up in late 1987, the new Windsor mill will produce commodity grades, with high productivity from long production runs.

Gas and Oil Investments

Since 1979, Domtar has shared in the development of the Elmworth-Wapiti gas field in West-Central Alberta, from which most of its energy revenues are currently derived. Domtar's competitiveness as a junior producer rests on its quality product, free of contamination and dependably supplied, and its low finding and production costs.

☐ *Domtar is a working-interest owner of the deep cut facility at Elmworth, near Grand Prairie, Alberta. The plant removes ethanes, propanes and butanes from the gas stream, increasing the value of the product.*

Corporate staff services

1.

Specialized analytical equipment, such as this scanning electron microscope, is being used by researchers at the Domtar Research Centre to explore the properties of materials of importance to Domtar's products.

Accounting for barely 3% of the total workforce, the corporate staff groups contribute significantly to Domtar's competitive posture and profitability.

Providing centralized support and assistance in specialized areas to the Corporation and its operating units, the staff groups provide expertise in such areas as computer technology, financial planning and management, employee relations, engineering, purchasing, occupational health and safety, loss control, research and environmental technology, thereby reinforcing Domtar's competitive thrust.

Corporate staff groups were involved in the following major activities in 1986:

— Selling to the public $75 million of preferred shares.

— Issuing to the public 1.4 million common shares. Together with a private placement of 1.1 million shares, this transaction generated $89 million.

— Increasing Domtar's financing flexibility by obtaining debentureholders' approval of amendments to the Corporation's Trust Deed.

— Acquiring a New Jersey-based chemical specialties producer, Miranol Chemical Company, Inc.

— Negotiating an agreement to purchase the gypsum business of Genstar Corporation in the United States.

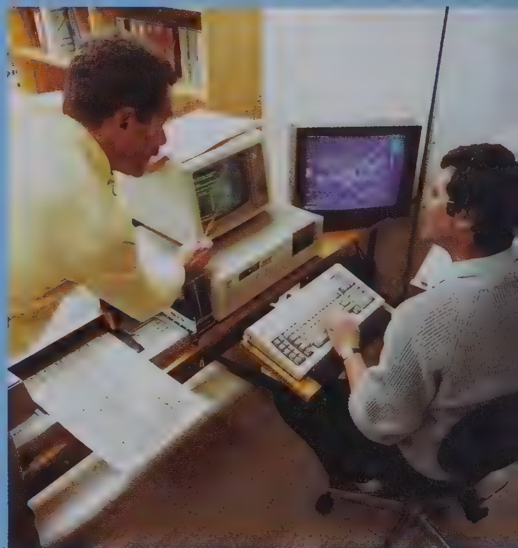
— Renewing 27 collective labour agreements in 1986, including nine brought forward from 1985.

— Fulfilling the commitments stipulated in Domtar's Francization Program and increasing the use of French within its Québec operations to the level intended by the Program. In recognition, the Québec Government's Office de la langue française (French Language Office) accorded Domtar its "Blue Seal" Certificate.

— Purchase and installation of twin-wire formers on two paper machines in Québec mills.

— Providing intensive training for Domtar employees in the handling and transportation of hazardous materials.

— Installation and start-up of a new corrugating medium machine in the Trenton mill.



2.

☐ *Domtar's Central Engineering personnel find computer-aided drafting is a fast, accurate and time-saving tool in process and system design.*

— Developing a number of promising new de-icing materials and one new product, Duroid® roofing membrane, which was successfully launched on the market.

— Initiating a joint Domtar / National Research Council research program to explore the biological conversion of lignin.

— Domtar researchers received the Canadian Pulp & Paper Association's 1986 I.H. Weldon Medal in recognition of research and technical excellence. For one of the recipients, it was the fourth such medal he had received.

Management's statement on responsibility for financial reporting and control

Management is responsible for the preparation and presentation of the information contained in the Annual Report. The consolidated financial statements included in the Annual Report are considered by management to present fairly the Corporation's consolidated financial position and results of operations.

These statements, including the notes thereto (pages 25 to 40) have been:
— used to derive the financial information in other parts of the Annual Report;
— prepared in accordance with generally accepted accounting principles;
— approved by the Board of Directors, and
— examined by the Corporation's auditors, Price Waterhouse and Raymond, Chabot, Martin, Paré, whose report is presented on page 26.

To express an opinion on the consolidated financial statements, the auditors develop and maintain an understanding of Domtar's accounting procedures and internal financial controls. These internal controls are designed to provide reasonable assurance that the Corporation's:
— written policies and procedures are followed;
— transactions are executed in accordance with appropriate authorizations;
— books, records and financial statements properly reflect the transactions of the Corporation;
— systems of internal control and organizational structure provide for appropriate delegation of authority and segregation of duties.

The system of internal control is monitored by the Corporation's internal auditors, whose function includes the review and the evaluation of the accounting records and related systems.

An Audit Committee composed of 5 directors, none of whom are officers of the Corporation, is appointed by the Board of Directors. Acting on behalf of the Board, the Committee:
— reviews the Corporation's annual consolidated financial statements;
— approves major accounting policies;
— periodically reviews with management and auditors the adequacy of the Corporation's principal internal controls.

The auditors of the Corporation have free and independent access to the Audit Committee and meet with the Committee periodically during the year to consider these and other matters.

Domtar Inc.
Five-year review of supplementary segmented information

(millions of dollars)

	1985	1984	1983	1982
Trade sales				
Fine papers	$ 538.9	$ 554.2	$ 492.2	$ 466.2
Newsprint, groundwood specialty papers, pulp & lumber*	350.1	341.8	366.2	368.3
Total pulp & paper	889.0	896.0	858.4	834.5
Packaging	375.4	342.6	290.2	256.2
Chemicals	286.3	281.9	260.5	269.8
Construction materials	572.7	518.4	406.0	322.6
Gas & oil	6.1	5.4	4.9	3.5
	$2,129.5	$2,044.3	$1,820.0	$1,686.6
Operating profit				
Fine papers	$ 45.7	$ 60.4	$ 46.2	$ 34.9
Newsprint, groundwood specialty papers, pulp & lumber*	16.4	8.3	6.7	10.3
Total pulp & paper	62.1	68.7	52.9	45.2
Packaging	33.1	37.7	17.5	(3.4)
Chemicals	23.4	13.7	13.3	24.0
Construction materials	55.2	36.8	11.5	(26.2)
Gas & oil	1.7	1.8	1.8	(4.1)
	$ 175.5	$ 158.7	$ 97.0	$ 35.5
Net operating assets				
Fine papers	$ 172.6	$ 172.0	$ 147.5	$ 143.7
Newsprint, groundwood specialty papers, pulp & lumber*	260.5	263.3	226.3	208.4
Total pulp & paper	433.1	435.3	373.8	352.1
Packaging	211.7	201.7	188.5	198.4
Chemicals	166.0	161.2	159.6	126.8
Construction materials	228.9	225.0	202.2	193.4
Gas & oil	64.1	61.8	58.2	58.8
	$1,103.8	$1,085.0	$ 982.3	$ 929.5
Return on average net operating assets				
Fine papers	26.5%	37.8%	31.7%	22.5%
Newsprint, groundwood specialty papers, pulp & lumber*	6.3	3.4	3.1	4.8
Total pulp & paper	14.3	17.0	14.6	12.3
Packaging	16.0	19.3	9.0	(2.0)
Chemicals	14.3	8.5	9.3	19.2
Construction materials	24.3	17.2	5.8	(12.8)
Gas & oil	2.7	3.0	3.1	(7.2)
	16.0%	15.4%	10.1%	3.8%
Pulp & paper production (metric tons)				
Newsprint & groundwood specialty papers	366,364	384,694	359,139	351,319
Fine & specialty papers	350,744	331,015	328,524	303,859
Market pulp	62,846	95,890	168,794	138,351
Kraft paper & boxboard*	39,745	41,325	99,769	125,654
Containerboard	352,156	351,572	301,614	254,533

* Includes a kraft paper and boxboard mill sold in 1983.

Review of operations

Raymond R. Pinard, Executive Vice-President and Chief Operating Officer.

Neil Martin, President, Chemicals Group.

Chemicals Group

Sifto® Salt The volume of rock salt sales for highway ice control declined due to exceptionally severe weather conditions in the first and fourth quarters of 1985. Weather patterns in 1986 returned to normal in Canada, while mild conditions prevailed throughout the Southern United States. These losses were partially offset by higher chemical volumes in Canada, reflecting new business and a general strengthening in the market.

Highway selling prices generally remained at 1985 levels. General trade prices declined, due principally to strong price competition in the United States.

The effect of lower sales on operating profit was moderated by reduced operating costs. The new energy-efficient vapour recompression production process at Amherst produced substantial savings in 1986.

Production at the Goderich mine was reduced in November and December following two separate gas explosions in an area of the mine under development. As a result, overall production for 1986 was at 91% of capacity. Changes in operating methods have brought the problem under control. At Cote Blanche, high opening inventories together with low weather-related demand in the Southern United States caused a substantial cutback in production, resulting in operations at 69% of capacity.

Coal tar Despite increased pitch purchases by the aluminum industry, sales in 1986 were 9% lower than in 1985, reflecting the impact of oil price deflation and generally weak markets throughout the distillate product range. To offset decreased prices, the division negotiated significant raw material cost reductions and developed alternative supply sources in the United States. Major capital spending programs to upgrade product quality and environmental compliance at the Hamilton plant were initiated during 1986.

Wood preserving Sales volume declined sharply reflecting a significant downturn in demand from railway and utility customers, together with a continuing absence of major government wharfage projects. Faced with these shortfalls, the division adopted widespread measures to reduce its operating costs, including the "mothballing" of its Newcastle, New Brunswick, plant.

Specialty chemicals Volume growth of 12% was achieved through continued penetration of the U.S. and Canadian markets. Direct margin also improved due to lower raw material costs. The acquisition of Miranol Chemical Company, Inc., a U.S. producer of specialty surfactants, was finalized in December 1986.

Construction Materials Group

Gypsum products As a result of strong demand in Eastern North America and Western United States, housing starts increased to 200,000 units in Canada and to 1.8 million units in the United States. The industry ran close to capacity in the markets served by Domtar.

Domtar's shipments of gypsum wallboard increased 29% from the 1985 level due to the strong market demand. This, combined with higher selling prices, significantly improved operating profit.

The division's largest plant at Caledonia is currently increasing the capacity of its major production line by approximately 15%. The Calgary plant was closed as the low demand in Western Canada forced the Group to rationalize its operations in this region.

Roofing and fibreboard products The market for roofing products improved in 1986 due to strong housing construction and re-roofing activity. Shipments of roofing products increased by 9%. Both Eastern plants operated full, while the two Western facilities ran at less than half their capacity.

The production of roofing shingles was transferred from Burnaby to the Lloydminster plant. The Burnaby facility will now concentrate on packaged goods and saturated felt. In late 1986, the division launched a new line of modified bitumen roofing products under the Duroid® trademark.

Pierre Dupuis, President, Construction Materials Group.

Elmer R. Puddington, President, Packaging Group.

In 1986, the industry's shipments of fibreboard products were the highest of the last 10 years, with all Canadian producers, including Domtar, operating at capacity. Late in the year, Domtar decided to invest $3 million for the modernization and the expansion of the Donnacona plant.

Insulation products Demand for insulation products was strong all year in Eastern Canada. The termination in 1986 of the Canadian Home Insulation Program provided an incentive to the home renovation industry. The volume of batts and rolls shipped increased 8% and operating profit improved as a result.

Laminated products The demand for Cladboard® low-pressure laminates continued to rise. Sales increased by 9%, as the Huntsville plant operated at capacity.

Sales of Arborite® high-pressure laminates grew by 4% due to the high level of renovation activity. Prices continued to be competitive.

Masonry products In July 1986, Domtar sold its two brick plants in Mississippi. With this sale, Domtar has withdrawn completely from the masonry business.

Packaging Group

Containerboard Shipments in 1986 were 5% above 1985 levels, and the division's three mills ran full for the third consecutive year. However, prices were below those in 1985, due to the threat of low-priced imports from the United States. As a result, operating profit was lower than in 1985. The completion in 1986 of a new corrugating medium machine at the Trenton mill and a new press section at the Red Rock linerboard mill will improve productivity and reduce costs in 1987 and the years ahead.

Recycling Demand for recycled paper increased in 1986, due to improved North American market conditions. As a result, shipments increased by 21%.

Corrugated containers Shipments in 1986 were marginally lower than in 1985, despite a stronger market, due to the Group's decision not to compete for business which did not meet minimum profit criteria. Average selling prices were also marginally below 1985 levels. As a result, operating profit declined in 1986.

Schiffenhaus Canada Inc., in which Domtar holds a one-third interest, started operations in 1986. During the fourth quarter, it fully met product quality and productivity expectations. The company produces preprinted linerboard for the Canadian and Northeastern United States markets.

Domtar Sonoco Containers Although shipments in 1986 were 9% lower, the division maintained its position as the leading Canadian producer of composite cans. However, selectively applied price increases, combined with manufacturing cost reductions, resulted in a higher operating profit in 1986.

Pulp & Paper Products Group

Fine papers Canadian demand for fine papers increased by 8% in 1986 compared to 1985, with uncoated offset papers, business papers, coated card and specialty grades displaying above average growth. In the United States, demand across all product segments rose by 9%. As a result of the improved demand, prices for commodity grades recovered from their severe decline in 1985. Canadian and United States mills operated, on average, at 95% capacity.

Domtar's fine paper sales increased by 7% in 1986, while operating profit was up by 23%.

Newsprint, groundwood specialty papers, pulp and lumber Sales increased by 21% in 1986, while operating profit more than tripled in the same period.

Roger A. Ashby, President, Pulp & Paper Products Group.

Frederick E. Hertha, Vice-President, Energy.

Newsprint and groundwood specialty papers North American demand for newsprint improved throughout 1986, with consumption increasing by 3.4%. However, selling prices remained at the 1985 level, due to competitive pressures. Domtar's shipments remained at the 1985 level. Conversion of the Dolbeau newsprint mill to full chemi-thermomechanical pulping is scheduled to be completed in late 1987. The project will improve product and environmental quality and reduce operating costs.

Demand for groundwood specialty papers increased by 7% while selling prices remained at the 1985 level. Domtar's shipments increased by 5%.

Pulp World demand for chemical pulp increased by 8% compared with 1985. In North America, demand began to strengthen from a low base in early 1986, and by mid-year most producers were operating at capacity. As a result of the improving demand, prices also began to recover from their depressed levels. These factors, combined with improved productivity and the implementation of cost reduction measures, significantly improved the performance of the Lebel-sur-Quévillon pulp mill.

Lumber North American demand for lumber increased by 5% due to strong housing starts. However, operating rates remained low at 85% as a result of excess capacity in the industry. Prices were on average 5% above the 1985 level. The 15% Canadian export tax imposed on softwood lumber shipments to the United States following intensive negotiations between the two countries in 1986 will seriously affect the Canadian lumber industry in the years ahead.

Work started on the Mistassini sawmill expansion to accomodate the changing wood requirements of the Dolbeau mill as a result of its conversion to chemi-thermomechanical pulping. The modernization of the White River facilities, aimed at significantly improving productivity, was completed in late 1986.

Gas and oil investments

Oil production increased significantly in 1986 as earlier discoveries were put on stream. Gas volume fell by 4% in 1986 due to lower demand. Liquids volume from the two extraction plants started up in late 1985 almost doubled as a result of a full year's production. Selling prices for all products fell sharply, in line with the decline in world energy prices. Higher operating costs and depletion charges were partially offset by lower royalties. Writing down the American Hunter assets by $1 million was the major factor contributing to the 1986 operating loss, compared to an operating profit in 1985.

Financial review

Derek J. Speirs, Vice-President, Finance and Corporate Development.

The year in review

Net earnings in 1986 amounted to $145 million or $3.20 per common share, compared to $110 million or $2.70 per common share in 1985. In both years, extraordinary gains were realized from the use of prior years' tax losses in the United States and from the sale of businesses. These totalled $9 million or $0.21 per common share in 1986 and $14 million or $0.37 per common share in 1985. The average number of common shares outstanding was 41.6 million during 1986, compared to 38.6 million in 1985. The increase reflected issues of common shares which took place in the second quarter of 1985 and in the third quarter of 1986.

Operating profit increased 44% in 1986 to $253 million, compared to $176 million in 1985.

Corporate income and expenses

Sundry Income Sundry income, net of expenses, decreased to $11 million from $18 million in 1985. A portion of the Corporation's cash and short-term investments is held in U.S. dollars. During 1986 the value of the Canadian dollar strengthened compared to the United States dollar, resulting in a foreign exchange loss for the year. In 1985, the Canadian dollar declined, producing an exchange gain. This change more than offset the higher level of interest income earned on cash and short-term investments.

Interest Expense As a result of a $17 million increase in interest capitalized on major capital projects, primarily the Windsor rehabilitation project, interest charged against earnings declined to $15 million from $30 million in 1985.

Income Taxes Due to the repeal of the inventory allowance deduction and a higher level of earnings in Canada, the effective tax rate on Canadian income increased from 41.5% in 1985 to 43.7%. The effective rate on the income of the Corporation's foreign subsidiaries increased from 28.1% in 1985 to 35.7% due to the higher proportion of income earned in the United States. The overall effective tax rate increased from 36.3% in 1985 to 41.1%.

The Corporation will use $12 million of investment tax credits to reduce its 1986 current income taxes, leaving $6 million of taxes payable. As at December 31, 1986 the Corporation has $38 million of recorded but unclaimed investment tax credits which, if not used, will expire in varying amounts each year until 1993.

The prior years' tax losses in the United States were fully utilized in 1986, resulting in an extraordinary gain of $6 million.

Return to investors

The "total return to investors" on Domtar's common shares reflects the combined return from the share price change and from dividends paid that are assumed to have been reinvested in additional shares of the Corporation. The results for Domtar are:

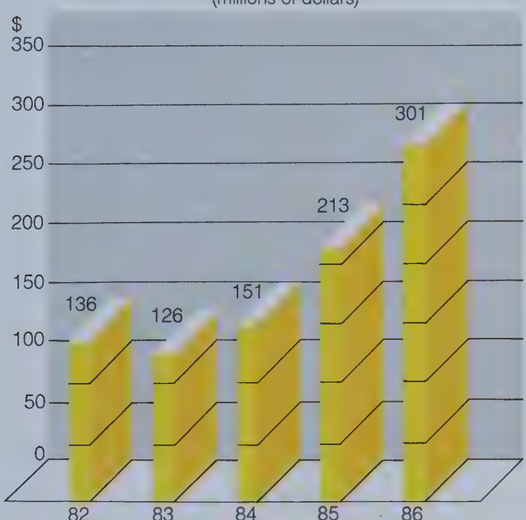
	1986	1985	1984	1983	1982
Dividend paid per common share	$ 0.97	0.79	0.60	0.50	0.75
Share price at year end	[illegible]	23.25	16.75	15.19	10.06
Total return to investors					
— 1 year	57.3%	44.5%	14.5%	56.5%	—
— 5 year	[illegible]	16.1%	12.8%	11.1%	12.9%

Changes in cash position

The key components of the changes in the Corporation's cash position are discussed below.

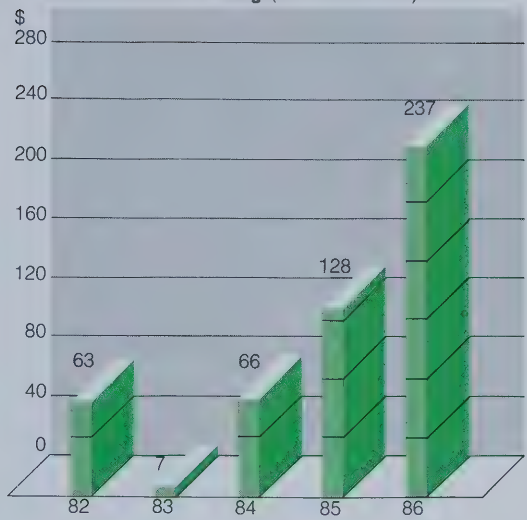
Operations The net cash flow from operations increased by 41% in 1986 to $301 million due to the higher levels of earnings and deferred income taxes. This included the net change in operating working capital during the year. In 1986, the Corporation changed two accounting policies, the effect being an increase in working capital of $19 million. Excluding the impact of this change, working capital decreased by $7 million, compared to a $5 million reduction in 1985.

Net cash flow from operations
(millions of dollars)



In 1986, receivables increased by $24 million due to a higher level of sales, while the number of days sales outstanding improved to 39 days from 40 at the end of 1985. Excluding the impact of the changes in accounting policy, inventories rose by $7 million. The number of days of inventory on hand increased to 44 days supply from 43 days in 1985. A substantial increase in payables amounting to $37 million mitigated these increases.

Financing (millions of dollars)



Financing During 1986, Domtar issued $75 million of preferred shares and $102 million of debentures and also received $89 million from the sale of common shares and investment tax credits. In addition, $30 million was received under the terms of the $150 million interest-free loan from the Federal and Québec governments. Long-term debt amounting to $82 million was repaid during the year.

Capital Investments In 1986, Domtar's net capital investments amounted to $443 million, including $269 million related to the Windsor rehabilitation project. Work continued on the conversion to 100% chemi-thermomechanical pulping of the newsprint mill at Dolbeau. All Operating Groups continued upgrading facilities to improve quality and productivity and to reduce operating costs.

The Corporation purchased the operations of the Miranol Chemical Company, Inc. of Dayton, New Jersey, a manufacturer of chemical specialties. Also, Domtar completed its withdrawal from the masonry business by the sale of its U.S. brick operations.

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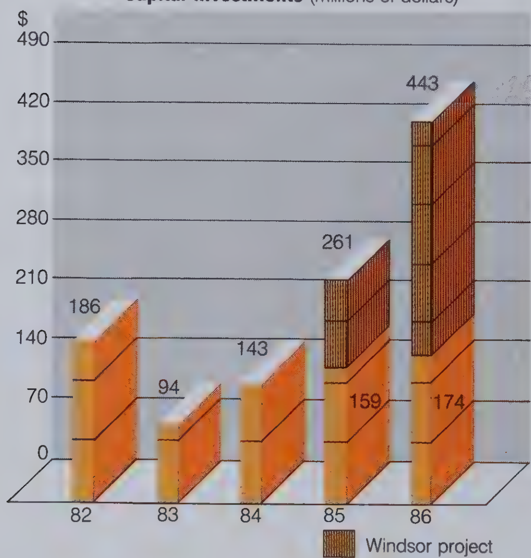
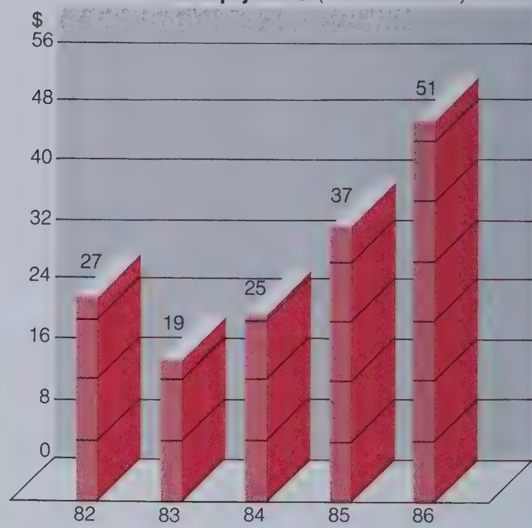
Capital investments (millions of dollars)



Dividends $51 million was paid in 1986, including $41 million on common shares. The quarterly dividend on common shares was increased in the second quarter of 1986 from $0.22 to $0.25 per share. As a result, the annual dividend was $0.97 per share in 1986, compared to $0.79 in 1985.

Dividend payments (millions of dollars)

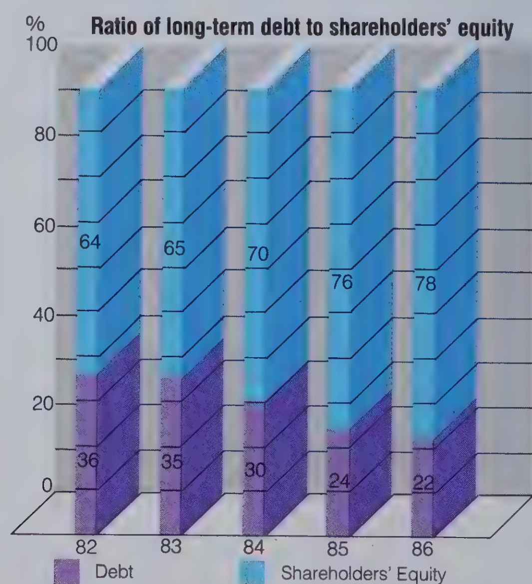


Liquidity and capital resources

Domtar's financial position continues to be strong. Cash at the end of 1986 amounted to $224 million. The ratio of current assets to current liabilities was 1.9:1, compared to 2.0:1 at December 31, 1985. The ratio of long-term debt to shareholders' equity strengthened to 22:78, from 24:76 at the end of 1985. The Corporation's "A" bond rating has been maintained.

The Corporation has an agreement with a syndicate of financial institutions for a committed credit facility totalling $500 million. At December 31, 1986, none of this facility was utilized. Other unused lines of credit totalled $228 million and are subject to periodic review.

Ratio of long-term debt to shareholders' equity



Domtar Inc. Consolidated statement of earnings

Year ended December 31
(millions of dollars,
except per share amounts)

	1986	1985	1984
Sales	$2,326.5	$2,129.5	$2,044.3
Operating expenses			
Cost of sales	1,811.2	1,709.7	1,654.0
Selling and administrative	171.8	162.5	159.2
Research	8.4	7.0	5.2
Depreciation and depletion	82.5	74.8	67.2
	2,073.9	1,954.0	1,885.6
Operating profit	252.6	175.5	158.7
Corporate expenses	16.3	13.0	12.2
Sundry income, net of expenses	(11.3)	(18.4)	(18.9)
Interest expense (note 10)	14.9	29.6	32.9
Earnings before income taxes, minority interest and extraordinary items	232.7	151.3	132.5
Income taxes (note 11)	95.7	54.9	45.8
Earnings before minority interest and extraordinary items	137.0	96.4	86.7
Minority interest	0.5	0.3	0.6
Earnings before extraordinary items	136.5	96.1	86.1
Extraordinary items (note 12)	8.5	14.3	4.4
Net earnings	$ 145.0	$ 110.4	$ 90.5
Per common share			
Earnings before extraordinary items	$2.99	$2.33	$2.22
Net earnings	$3.20	$2.70	$2.34
Dividends	$0.97	$0.79	$0.60

See accompanying notes to financial statements

Domtar Inc. Consolidated balance sheet

December 31
(millions of dollars)

Assets	1986	1985
Current assets		
Cash and short-term investments	$ 224.0	$ 179.9
Receivables	292.7	269.1
Inventories (note 3)	271.3	245.2
Prepaid expenses	7.9	8.2
	795.9	702.4
Investments and advances	24.0	23.2
Fixed assets		
Plant, machinery and facilities	1,661.2	1,545.3
Timber limits and land	65.5	54.4
Gas and oil properties	80.1	76.3
Assets under construction	442.0	157.9
	2,248.8	1,833.9
Less: Accumulated depreciation and depletion	828.4	771.6
	1,420.4	1,062.3
Intangible assets and deferred charges (note 4)	29.4	10.9
	$2,269.7	$1,798.8

Auditors' report

To the Shareholders of Domtar Inc.:

We have examined the consolidated balance sheet of Domtar Inc. as at December 31, 1986 and the consolidated statements of earnings, retained earnings and changes in cash position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its cash position for the year then ended in accordance with generally accepted accounting principles applied, except for the changes in the method of valuation of inventories as explained in note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Price Waterhouse
Chartered Accountants

Raymond, Chabot, Martin, Paré
Chartered Accountants

Montréal, February 5, 1987

Liabilities and shareholders' equity	1986	1985
Current liabilities		
Trade and other payables	$ 262.8	$ 229.0
Payables on capital projects	54.8	32.0
Income and other taxes payable	11.8	8.7
Dividends payable	3.4	1.6
Long-term debt due within one year (note 6)	84.4	77.7
	417.2	349.0
Long-term debt (note 6)	321.4	275.7
Deferred income taxes	280.2	225.4
Deferred credits	121.0	73.1
Minority interest	3.8	3.8
Preferred shareholders' equity (note 8)	150.2	75.7
Common shareholders' equity		
Common shares (note 8)	423.7	343.8
Retained earnings	556.3	456.2
Accumulated foreign currency translation adjustments (note 9)	(4.1)	(3.9)
	975.9	796.1
	$2,269.7	$1,798.8

See accompanying notes to financial statements

Approved by the Board:

Yves Pratte, Q.C., Director
James H. Smith, Director

Domtar Inc. Consolidated statement of changes in cash position

Year ended December 31
(millions of dollars)

		1986	1985	1984
	Cash provided by (used for):			
(A)	Operations	$ 301.2	$ 213.0	$ 150.9
(B)	Financing	236.6	127.7	66.2
(C)	Capital investments	(443.2)	(261.4)	(142.6)
	Dividend payments	(50.5)	(36.9)	(25.2)
	Increase during the year	44.1	42.4	49.3
	Cash at beginning of year	179.9	137.5	88.2
	Cash at end of year	$ 224.0	$ 179.9	$ 137.5
(A)	**Operations**			
	Earnings before extraordinary items	$ 136.5	$ 96.1	$ 86.1
	Items not requiring cash:			
	Depreciation and depletion	82.5	74.8	67.2
	Deferred income taxes	76.6	33.5	23.9
	Other	(0.8)	0.8	(0.4)
	Cash flow from operations	294.8	205.2	176.8
	Cash provided by (invested in) operating working capital (see page 29)	7.3	5.1	(29.5)
	Foreign currency translation adjustments relating to operating working capital of self-sustained operations	(0.9)	2.7	3.6
	Net cash flow from operations	$ 301.2	$ 213.0	$ 150.9
(B)	**Financing**			
	Long-term debt issued, net of expenses	$ 131.2	$ 98.4	$ —
	Long-term debt repaid	(81.5)	(80.2)	(24.5)
	Preferred shares issued, net of expenses	73.9	—	63.7
	Common shares issued, net of expenses	78.9	64.5	4.1
	Investment tax credits utilized	12.0	13.8	12.5
	Investment tax credits sold	12.4	11.8	—
	Government grants for fixed assets acquired	10.0	19.7	6.4
	Other	(0.3)	(0.3)	4.0
		$ 236.6	$ 127.7	$ 66.2
(C)	**Capital investments**			
	Fixed assets acquired	$ 457.1	$ 284.4	$ 132.9
	Businesses purchased (note 15)	18.1	16.0	27.3
	Fixed assets sold	(18.0)	(19.4)	(18.0)
	Change in payables on capital projects	(22.8)	(16.0)	(7.2)
	Other	8.8	(3.6)	7.6
		$ 443.2	$ 261.4	$ 142.6

See accompanying notes to financial statements

Domtar Inc. Consolidated statement of changes in cash position (cont'd)

Year ended December 31
(millions of dollars)

	1986	1985	1984
Cash provided by (invested in) operating working capital			
Receivables	$(23.6)	$(19.8)	$(15.7)
Inventories	(26.1)	(6.7)	(33.7)
Prepaid expenses	0.3	0.1	(2.8)
Trade and other payables	33.8	27.6	18.5
Income and other taxes payable	3.1	1.6	(1.4)
	(12.5)	2.8	(35.1)
Add back: Operating working capital at date of purchase of businesses purchased (note 15)	1.2	2.3	5.6
Impact of changes in accounting policies	18.6	—	—
	$ 7.3	$ 5.1	$(29.5)

Consolidated statement of retained earnings

Year ended December 31
(millions of dollars)

	1986	1985	1984
Balance at beginning of year	$456.2	$384.4	$321.9
Impact of changes in accounting policies, net of income taxes of $6.8 (note 2)	9.3	—	—
Net earnings	145.0	110.4	90.5
	610.5	494.8	412.4
Deduct:			
Expenses on issue of shares, net of income taxes of $1.6 (1985 - $1.1)	2.1	1.7	1.3
Dividends declared			
Preference shares	0.4	0.5	0.5
Preferred shares	11.2	5.8	4.2
Common shares	40.5	30.6	22.0
	54.2	38.6	28.0
Balance at end of year	$556.3	$456.2	$384.4

See accompanying notes to financial statements

Domtar Inc. Notes to consolidated financial statements

(millions of dollars, unless otherwise noted)

1. Summary of significant accounting policies

The financial statements have been prepared in accordance with generally accepted accounting principles in Canada.

Principles of consolidation
The accompanying financial statements include the accounts of Domtar Inc. and all its subsidiaries.

Translation of foreign currencies
For foreign subsidiaries which are considered financially and operationally self-sustaining, the current-rate method of translation of foreign currencies is followed. Therefore all gains and losses arising from the translation of the financial statements of these foreign subsidiaries are deferred in an "Accumulated Foreign Currency Translation Adjustments" account in common shareholders' equity. For foreign subsidiaries which are considered financially and operationally integrated with the Corporation, the temporal method of translation of foreign currencies is followed. Therefore gains and losses resulting from the translation are included in the determination of earnings.

The gains and losses resulting from the translation of foreign currency transactions of the Corporation and its Canadian subsidiaries are included in net earnings, except for those on long-term debt denominated in foreign currency. For such debt designated as a hedge of the net investment in foreign subsidiaries, exchange gains and losses are included in the "Accumulated Foreign Currency Translation Adjustments" account. For the remaining long-term debt denominated in foreign currency, exchange gains and losses are deferred and amortized over the remaining term of the related obligation. Exchange gains and losses pertaining to long-term debt covered by currency exchange agreements are offset against losses and gains deriving from those currency exchange agreements.

Valuation of inventories
Inventories of raw materials and operating and maintenance supplies are valued at average cost. Finished goods and work in process are valued at the lower of average cost and net realizable value and include the cost of raw materials, direct labour and manufacturing overhead expenses.

Investments and advances
Investments in companies over which the Corporation has significant influence are accounted for by the equity method. Other investments and advances are stated at cost.

Fixed assets, depreciation and depletion
Fixed assets are recorded at cost. Interest cost is capitalized on additions to property and plant which are in excess of $10 million ($1 million in 1984) and for which the period of construction exceeds one year. The interest rate used is equal to the weighted average of the interest rates on long-term debt. Assets under construction represent those additions to property and plant on which interest is capitalized.

For timber limits and gas and oil well equipment, depletion is provided on the unit of production method. For all other assets, depreciation is provided on the straight-line method using rates based on the estimated useful lives of the assets which are generally as follows:

Buildings	Up to 40 years
Production machinery	Up to 20 years
Ships	Up to 15 years
Logging equipment	Up to 6 years
Automobiles	4 years

The Corporation follows the full cost method of accounting for gas and oil properties. Under this method, all costs incurred in acquiring, exploring and developing properties are capitalized, with Canada and the United States being considered as separate cost centres. Such costs are depleted using the unit of production method based upon the estimated proven reserves of gas and oil. The cost centres are reviewed annually and, if impairment to value is determined, the capitalized costs are written down.

The depreciation and depletion expense is reported net of the amount of amortization of deferred credits. No depreciation is taken on assets under construction.

Intangible assets and deferred charges
Intangible assets and deferred charges are recorded at cost. Goodwill and other intangibles are amortized on a straight-line basis over periods not exceeding 25 years. Expenses incurred in issuing long-term debt are amortized on a straight-line basis over the term of the related obligations. Preproduction costs, including training and start-up expenses, on projects in excess of $150 million are deferred and amortized on a straight-line basis over a five-year period commencing with the start-up of commercial operations.

Deferred credits
Deferred credits comprise both government grants and investment tax credits earned in acquiring fixed assets. They are amortized on the same basis as the related fixed assets, and are reported net of accumulated amortization.

Income taxes
The Corporation provides for income taxes on the tax allocation basis. Accordingly, deferred income tax provisions are recorded in the consolidated statement of earnings in order to reflect the income tax effects of timing differences, principally due to depreciation and depletion claimed for income tax purposes in excess of amounts recorded for financial statement purposes.

The Corporation does not provide for income taxes on undistributed income of foreign subsidiaries as such income is being reinvested in foreign operations.

Pension costs
Pension costs associated with current service are expensed and funded in the period in which the service is rendered. Past service costs remaining to be charged to operations are amortized and funded over periods not exceeding those during which funding is permitted by the applicable regulatory bodies.

2. Changes in accounting policies

Prior to 1986, certain spare parts were inventoried while others were expensed on purchase. Effective January 1, 1986 the Corporation changed its accounting policy prospectively, to include all spare parts in inventory. This change has had the effect of increasing the retained earnings by $4.6 million. Had the change not been made, net earnings for 1986 would have been reduced by $1.4 million ($0.03 per common share). The effect on net earnings for 1985 and prior years cannot be readily determined.

In addition, prior to 1986 the valuation of certain inventories excluded certain manufacturing overhead expenses. Effective January 1, 1986 the Corporation changed its accounting policy prospectively, to include manufacturing overhead expenses in the valuation of all inventories. This change has had the effect of increasing the retained earnings by $4.7 million. Had the change not been made, net earnings for 1986 would have been reduced by $1.0 million ($0.02 per common share). The effect on net earnings for 1985 and prior years cannot be readily determined.

3. Inventories

	1986	1985
Finished goods and work in process	$135.0	$121.2
Raw materials	92.1	96.0
Operating and maintenance supplies	44.2	28.0
	$271.3	$245.2

4. Intangible assets and deferred charges

	1986	1985
Goodwill and other intangibles	$15.3	$ 3.6
Debt issue expenses	2.3	1.6
Unrealized exchange losses	4.4	5.7
Preproduction costs	7.4	—
Balance at end of year	$29.4	$10.9
Amount amortized during the year	$ 6.2	$ 3.9

5. Unused lines of credit

At December 31, 1986 the Corporation has an agreement with a syndicate of financial institutions for a committed credit facility totalling $500 million or the U.S. dollar equivalent. The full amount of the credit facility will be available until January 31, 1991, and then at reducing amounts until termination on January 31, 1996. At December 31, 1986 none of the facility was being utilized.

In addition, the Corporation has unused uncommitted bank lines of credit of $228.3 million.

Interest rates on all these lines of credit vary from bankers' acceptances (usually below bank prime) to bank prime, or are related to the London Interbank Offered Rate.

6. Long-term debt

	Maturity	1986	1985
Secured debentures			
$6\frac{1}{8}$% Series "E"	1990	$ 11.5	$ 11.5
$7\frac{1}{4}$% Series "F"	1987	12.9	12.9
$11\frac{1}{2}$% Series "G"	1995	26.6	26.6
$10\frac{1}{8}$% Series "H" (U.S. $35.8; 1985 U.S. $38.6)	1996	49.4	53.9
$12\frac{3}{4}$% Series "I" (U.S. $36.5; 1985 U.S. $42.0)	2000	50.3	58.7
10.35% Debentures	2006	102.4	—
$17\frac{1}{4}$% Bank loan (U.S. $50.0)	1986	—	69.9
$7\frac{1}{2}$% Notes (Swiss Francs 90.0)	1987	77.0	61.1
$6\frac{3}{8}$% Notes (Swiss Francs 44.0)	1989	37.7	29.9
Non-interest-bearing Notes	1995/96	60.0	30.0
Convertible Notes	1990	1.4	1.7
		429.2	356.2
Exchange adjustment arising from hedging Swiss Franc Notes to U.S. dollars		(23.4)	(2.8)
		405.8	353.4
Less: Due within one year		84.4	77.7
		$321.4	$275.7

Interest rates on the secured debentures shown above include the increase of 1/2 of 1% per annum effective from May 30, 1986 resulting from amendments to the Corporation's Trust Deed.

The secured debentures are secured by a floating charge on the assets of Domtar Inc. (as an entity), other than real and immovable properties. Both the secured debentures and the 10.35% debentures have sinking fund requirements.

The Corporation has hedged principal and interest payments on the 6 3/8% Swiss Franc (SF) Notes and on SF67 million of the SF90 million 7 1/2% Notes through currency exchange agreements with Canadian banks, pursuant to which the Corporation has agreed to exchange U.S. dollars for Swiss Francs. Hedging costs are classified in the consolidated statement of earnings as a reduction of sundry income.

In accordance with its policy on translation of foreign currencies, the Corporation has designated the Series "H" and "I" secured debentures and the hedged Notes in Swiss Francs as a hedge of its net investment in foreign subsidiaries.

In 1985, the Corporation obtained from the Federal and Québec governments a non-interest-bearing loan of $150 million to be received, during the period 1985-89, at the rate of $30 million per year, with each portion repayable 10 years after its receipt date.

The Convertible Notes, which bear interest at the prime rate, were issued in 1980 to certain officers of the Corporation and are convertible into common shares at the rate of $12.61 per share, determined on the basis of the fair market value of the common shares immediately prior to the issue of the Notes. The Notes are also redeemable at any time by the Corporation.

Long-term debt, as at December 31, 1986, due for retirement or sinking fund provisions in each of the next five years amounts to:

1987	1988	1989	1990	1991
$84.4	$7.8	$35.6	$26.1	$14.4

7. Commitments and contingent liabilities

The Corporation is committed under an agreement dated October 10, 1986 to purchase all of the outstanding shares of Genstar Gypsum Products Company for a cash consideration of U.S. $241 million. On January 13, 1987 the Corporation was advised by the United States Department of Justice of its intention to challenge the purchase, on the grounds that it will lessen competition in the sale of gypsum wallboard in Southern California, Southern Nevada and Arizona. Negotiations are currently underway aimed at resolving the dispute in a mutually satisfactory manner.

In addition, the Corporation has commitments for capital expenditures, primarily for the rehabilitation of the fine paper mill at Windsor, Québec, totalling approximately $122 million at December 31, 1986.

Minimum rental commitments under operating leases, determined as at December 31, 1986 amount to:

1987	1988	1989	1990	1991	Thereafter	Total
$18.2	$12.5	$8.5	$6.5	$5.3	$35.0	$86.0

Total rental expense amounted to $21.5 million in 1986 (1985 — $19.9 million; 1984 — $16.7 million).

The Corporation is party to various claims and lawsuits which are being contested. In the opinion of management, the outcome of such claims and lawsuits will not have a material adverse effect on the Corporation.

8. Stated capital

Preference shares
There are 435,289 (1985 — 455,416; 1984 — 476,916) preference shares authorized and outstanding at a stated value of $23.50 per share. The preference shares are non-voting, redeemable at $25.00 per share and carry a cumulative cash dividend of $1.00 per annum. During 1986, 20,127 (1985 — 21,500; 1984 — 36,000) preference shares were purchased for cancellation for $0.3 million (1985 — $0.3 million; 1984 — $0.5 million).

Serial preferred shares
The authorized serial preferred shares consist of an unlimited number of preferred shares issuable in series, ranking junior to the preference shares and with all series ranking equal with respect to the payment of dividends and the distribution of assets.

Series A
There are 2,600,000 (1985 and 1984 — 2,600,000) Series A Preferred Shares outstanding at a stated value of $25.00 per share. The Series A Preferred Shares are non-voting, retractable at the holder's option on April 2, 1992 at $25.00 per share, redeemable at the Corporation's option after April 1, 1992 at $25.40 per share, reducing by $0.20 per year, redeemable after April 1, 1994 at $25.00 and carry a cumulative cash dividend per share of $2.25 per annum.

Series B
There are 3,000,000 (1985 and 1984 — nil) Series B Preferred Shares outstanding at a stated value of $25.00 per share. The Series B Preferred Shares are non-voting and redeemable at the Corporation's option after April 1, 1991 at $25.00 per share. The Series B Preferred Shares carry a cumulative cash dividend of 8.4% per annum up to April 2, 1991 and, thereafter at 72% of bank prime.

Common shares

There is no limit on the number of common shares the Corporation may issue. Changes in the number of outstanding common shares and their aggregate stated value since January 1, 1984 are as follows:

	1986		1985		1984	
	Number of Shares	$	Number of Shares	$	Number of Shares	$
Balance at beginning of year	40,399,884	343.8	36,838,550	277.6	36,569,336	273.5
Shares issued for convertible notes	27,766	0.4	3,966	0.1	31,728	0.4
Stock dividends in lieu of cash dividends	7,458	0.2	15,860	0.3	17,390	0.3
Shares issued for cash	2,526,707	79.3	3,541,508	65.8	220,096	3.4
Balance at end of year	42,961,815	423.7	40,399,884	343.8	36,838,550	277.6
Book value per common share at end of year		$22.71		$19.71		$17.89

Book value per common share is the sum of the stated value of common shares, retained earnings and accumulated foreign currency translation adjustments divided by the number of common shares outstanding at the year-end.

9. Accumulated foreign currency translation adjustments

	1986	1985
Balance at beginning of year	$(3.9)	$ (2.9)
Reduction due to a decrease in the net investment in a foreign subsidiary	(0.6)	—
Effect of changes in exchange rates during the year:		
On the net assets of foreign subsidiaries	(1.7)	9.6
On certain long-term debt denominated in foreign currency designated as a hedge of the net investment in foreign subsidiaries	2.1	(10.6)
Balance at end of year	$(4.1)	$ (3.9)

10. Interest expense

	1986	1985	1984
Interest on long-term debt	$36.7	$34.4	$34.7
Less: Amount capitalized	23.0	5.6	2.2
	13.7	28.8	32.5
Interest on other indebtedness	1.2	0.8	0.4
	$14.9	$29.6	$32.9

11. Income taxes

Effective income tax rate

The income tax expense of the Corporation differed from the income taxes computed at the Canadian statutory rate and at the composite rate of the foreign countries where the Corporation operates. The principal factors causing this difference were as follows:

	1986		
	Canadian	Foreign	Total
Earnings before income taxes, minority interest and extraordinary items	$158.1	$74.6	$232.7
Income taxes at statutory rates of the respective countries	$ 74.5	$26.4	$100.9
Income tax allowances			
- manufacturing and processing	(8.1)	—	(8.1)
- inventory	(0.4)	—	(0.4)
- resource deduction	(1.9)	—	(1.9)
Mining taxes	4.0	—	4.0
Other items	1.0	0.2	1.2
Income tax expense	$ 69.1	$26.6	$ 95.7
Effective income tax rate	43.7%	35.7%	41.1%

	1985		
	Canadian	Foreign	Total
Earnings before income taxes, minority interest and extraordinary items	$92.6	$58.7	$151.3
Income taxes at statutory rates of the respective countries	$44.0	$17.1	$ 61.1
Income tax allowances			
- manufacturing and processing	(4.5)	—	(4.5)
- inventory	(2.6)	—	(2.6)
- resource deduction	(1.4)	—	(1.4)
Mining taxes	3.3	—	3.3
Other items	(0.4)	(0.6)	(1.0)
Income tax expense	$38.4	$16.5	$ 54.9
Effective income tax rate	41.5%	28.1%	36.3%

	1984		
	Canadian	Foreign	Total
Earnings before income taxes, minority interest and extraordinary items	$88.9	$43.6	$132.5
Income taxes at statutory rates of the respective countries	$41.4	$10.3	$ 51.7
Income tax allowances			
- manufacturing and processing	(4.6)	—	(4.6)
- inventory	(2.3)	—	(2.3)
- resource deduction	(1.0)	—	(1.0)
Mining taxes	1.1	—	1.1
Other items	1.1	(0.2)	0.9
Income tax expense	$35.7	$10.1	$ 45.8
Effective income tax rate	40.2%	23.2%	34.6%

12. Extraordinary items

The extraordinary items consist of:

	1986	1985	1984
Reduction of income taxes arising from the use of the unrecorded tax benefit of prior years' losses of United States subsidiaries	$6.2	$11.5	$ 7.2
Gain (loss) on sale of assets, net of income taxes (recovery) of $(1.4) (1985 — $0.8; 1984 — $(0.8))	[illegible]	2.8	(2.8)
	$8.5	$14.3	$ 4.4

13. Pension plans

The Corporation has various pension plans for its employees. As at December 31, 1986 pension fund assets exceeded the liability for pension benefits by approximately $26 million (1985 — net liability of $1 million). The liability for pension benefits includes amendments improving the benefits from the main Canadian pension plans to non-unionized employees who retire prior to January 2, 1988 and to unionized employees who retire prior to May 2, 1987.

Had the benefits resulting from the above amendments been extended to all future retirees, the liability for past service benefits would have been increased by $59 million. Consequently, a net liability for benefits in respect of past service remaining to be charged to operations amounting to $33 million would have resulted, which would be amortized and funded over periods of up to 15 years in Canada and up to 35 years in the United States.

The above amounts are calculated on the assumption that operations will continue and on the basis of actuarial determinations used for funding purposes which reflect assumed future compensation levels, where appropriate.

The market value of the net assets in trust and available for benefits at December 31, 1986 is $448.5 million (1985 — $396.6 million).

14. Related parties

The Corporation is not aware of having entered into any transaction other than on normal commercial terms and in the ordinary course of business with either of the Corporation's major shareholders, Dofor Inc. and Caisse de dépôt et placement du Québec or any party related thereto.

15. Businesses purchased

Effective December 12, 1986, the Corporation purchased the productive facilities of Miranol Chemical Co. Inc., a United States manufacturer of specialty chemicals, for $18.1 million. The transaction was for cash and has been accounted for as a purchase. The results of operations since the date of purchase have been included in the consolidated financial statements.

The following is a summary of the assigned values of the net assets purchased:

	1986	1985	1984
Fixed assets	$ 7.5	$13.7	$21.7
Working capital	1.2	2.3	5.6
Goodwill	9.4	—	—
Total cost of net assets purchased	$18.1	$16.0	$27.3

16. Segmented information

The Corporation's operations and assets by industry segment and by geographic area are as follows:

	1986	1985	1984	1983	1982
By industry segment					
Trade sales					
Pulp and paper					
Fine papers	$ 574.6	$ 538.9	$ 554.2	$ 492.2	$ 466.2
Other	422.1	350.1	341.8	366.2	368.3
	996.7	889.0	896.0	858.4	834.5
Packaging	385.6	375.4	342.6	290.2	256.2
Chemicals	267.8	286.3	281.9	260.5	269.8
Construction materials	670.8	572.7	518.4	406.0	322.6
Gas and oil	5.6	6.1	5.4	4.9	3.5
Consolidated sales	$2,326.5	$2,129.5	$2,044.3	$1,820.0	$1,686.6
Inter-segment sales	$ 24.8	$ 19.5	$ 22.4	$ 25.4	$ 25.7
Operating profit (loss)					
Pulp and paper	$ 109.1	$ 62.1	$ 68.7	$ 52.9	$ 45.2
Packaging	20.7	33.1	37.7	17.5	(3.4)
Chemicals	20.4	23.4	13.7	13.3	24.0
Construction materials	103.5	55.2	36.8	11.5	(26.2)
Gas and oil	(1.1)	1.7	1.8	1.8	(4.1)
	$ 252.6	$ 175.5	$ 158.7	$ 97.0	$ 35.5

	1986	1985	1984	1983	1982
By industry segment (cont'd)					
Identifiable assets					
Pulp and paper	$ 645.2	$ 569.2	$ 531.3	$ 463.6	$ 431.6
Packaging	340.7	282.9	254.0	228.9	237.3
Chemicals	218.5	208.8	197.0	195.1	164.1
Construction materials	304.3	297.1	281.4	250.0	233.4
Gas and oil	65.5	68.7	66.1	62.2	63.2
	1,574.2	1,426.7	1,329.8	1,199.8	1,129.6
Assets under construction	442.0	157.9	23.2	37.6	81.4
Corporate	253.5	214.2	168.4	112.8	106.3
	$2,269.7	$1,798.8	$1,521.4	$1,350.2	$1,317.3
Depreciation and depletion					
Pulp and paper	$ 31.7	$ 27.6	$ 25.5	$ 25.3	$ 24.5
Packaging	18.2	16.0	12.9	12.9	10.9
Chemicals	10.6	10.7	11.2	10.4	10.1
Construction materials	17.3	17.7	15.6	14.9	14.6
Gas and oil	4.7	2.8	2.0	1.9	2.6
	$ 82.5	$ 74.8	$ 67.2	$ 65.4	$ 62.7
Fixed assets acquired (excluding businesses purchased)					
Pulp and paper	$ 375.6	$ 186.6	$ 60.6	$ 64.9	$ 75.6
Packaging	38.4	57.8	34.2	8.8	35.7
Chemicals	8.0	14.8	12.5	16.9	33.3
Construction materials	28.7	17.9	16.7	10.0	11.9
Gas and oil	4.9	5.9	7.3	6.2	11.3
	455.6	283.0	131.3	106.8	167.8
Corporate	1.5	1.4	1.6	0.9	1.0
	$ 457.1	$ 284.4	$ 132.9	$ 107.7	$ 168.8

	1986	1985	1984	1983	1982
By geographic area					
Trade sales					
Canada					
Within Canada	$1,550.1	$1,428.9	$1,375.8	$1,299.1	$1,204.1
To United States	369.8	321.2	326.2	300.1	293.1
Offshore	46.9	49.0	48.2	38.5	52.4
	1,966.8	1,799.1	1,750.2	1,637.7	1,549.6
United States	359.1	330.1	293.9	180.9	128.9
Other	1.1	0.3	0.2	1.4	8.1
Consolidated sales	$2,326.5	$2,129.5	$2,044.3	$1,820.0	$1,686.6
Intercompany sales between geographic areas	$ 122.9	$ 89.6	$ 89.8	$ 58.3	$ 46.8
Operating profit (loss)					
Canada	$ 183.0	$ 129.5	$ 126.8	$ 89.5	$ 55.7
United States	58.4	36.7	23.7	(0.4)	(21.9)
Other	11.2	9.3	8.2	7.9	1.7
	$ 252.6	$ 175.5	$ 158.7	$ 97.0	$ 35.5
Identifiable assets					
Canada	$1,803.9	$1,371.4	$1,152.5	$1,060.5	$1,049.2
United States	195.4	193.9	181.4	157.5	141.8
Other	16.9	19.3	19.1	19.4	20.0
	2,016.2	1,584.6	1,353.0	1,237.4	1,211.0
Corporate	253.5	214.2	168.4	112.8	106.3
	$2,269.7	$1,798.8	$1,521.4	$1,350.2	$1,317.3

Sales to other segments reflect transfer prices at market value.

Segment operating profit represents sales less allocable expenses before corporate expenses, sundry income, interest expense and income taxes.

Segment identifiable assets are those which are directly used in segment operations or geographic areas. Corporate assets are principally marketable securities, certain non-trade receivables, prepaid items and other assets.

Quarterly financial information (unaudited)

(millions of dollars, except per share amounts)

	1st	2nd	3rd	4th	Year
1986					
Sales	$562.7	$574.3	$585.0	$604.5	$2,326.5
Gross profit	121.5	121.0	132.0	140.8	515.3
Earnings before extraordinary items	31.3	29.1	33.5	42.6	136.5
Net earnings	37.5	29.1	37.4	41.0	145.0
Per common share					
Earnings before extraordinary items	$ 0.72	$ 0.64	$ 0.71	$ 0.92	$ 2.99
Net earnings	$ 0.88	$ 0.64	$ 0.80	$ 0.88	$ 3.20
Market price					
High	$ 31	$ 33⅞	$ 35¾	$ 36¼	$ 36¼
Low	$ 21⅞	$ 29¼	$ 28⅝	$ 31¼	$ 21⅞
1985					
Sales	$527.3	$527.5	$525.7	$549.0	$2,129.5
Gross profit	105.9	99.3	97.4	117.2	419.8
Earnings before extraordinary items	28.8	18.7	19.3	29.3	96.1
Net earnings	34.0	20.0	25.1	31.3	110.4
Per common share					
Earnings before extraordinary items	$ 0.74	$ 0.46	$ 0.44	$ 0.69	$ 2.33
Net earnings	$ 0.88	$ 0.50	$ 0.58	$ 0.74	$ 2.70
Market price					
High	$ 19¾	$ 19⅜	$ 22⅜	$ 23¼	$ 23¼
Low	$ 16⅝	$ 17½	$ 18⅛	$ 18¼	$ 16⅜

Domtar Inc. Eleven-year historical summary

(millions of dollars, except per share amounts and statistical data)

Operations	**Sales**		[illegible]
	Expenses	Operating and corporate expenses	[illegible]
		Interest expense	[illegible]
		Income taxes	[illegible]
		Other income — Net	[illegible]
		Extraordinary items	[illegible]
	Net earnings (loss)		[illegible]
Financial position	**Assets**	Cash and short-term investments	$ 124.0
		Other current assets	371.9
		Net fixed assets	1 420.4
		Other assets	63.4
		Total assets	$2,269.7
	Liabilities and shareholders' equity	Current liabilities	$ 417.2
		Long-term debt	321.4
		Deferred credits	121.0
		Deferred income taxes	280.2
		Minority interest	3.0
		Preferred shareholders' equity	150.2
		Common shareholders' equity	975.9
		Total liabilities and shareholders' equity	$2,269.7
Changes in cash position	**Operations**	Cash flow from operations	[illegible]
		Working capital change	[illegible]
	Financing	Long-term debt and equity financing	[illegible]
		Repayments and other — Net	[illegible]
	Capital Investments	Fixed assets acquired	[illegible]
		Businesses purchased	[illegible]
		Divestitures and other — Net	[illegible]
	Dividends	Payments	[illegible]
	Increase (decrease) in cash position		[illegible]
Other data	**Per common share**	Net earnings (loss)	$ [illegible]
		Dividends	$ 0.97
		Cash flow from operations	$ [illegible]
		Common shareholders' equity	$ 22.71
		Price range — High	$ [illegible]
		— Low	$ [illegible]
	Ratios	Total return to investors	56.3%
		Return on common shareholders' equity	14.1%
		Debt: equity ratio	[illegible]
	Other statistics	Number of common shareholders	[illegible]
		Number of preferred shareholders	[illegible]
		Common shares outstanding (millions)	[illegible]
		Number of employees	[illegible]
		Salaries, wages and benefits	$ [illegible]

1985	1984	1983	1982	1981	1980	1979	1978	1977	1976
2,129.5	2,044.3	1,820.0	1,686.6	1,764.7	1,653.2	1,495.4	1,240.9	1,009.5	886.8
1,967.0	1,897.8	1,733.0	1,662.6	1,676.4	1,488.2	1,317.6	1,131.0	958.2	860.7
29.6	32.9	29.9	23.4	17.9	15.3	16.8	17.0	16.9	14.3
54.9	45.8	18.6	2.3	30.9	69.7	72.8	42.7	16.0	7.9
(18.1)	(18.3)	(0.3)	(7.3)	(11.6)	(12.6)	(6.3)	(10.8)	(6.4)	(6.8)
(14.3)	(4.4)	0.7	10.7	(4.2)	2.0	—	—	—	—
110.4	90.5	38.1	(5.1)	55.3	90.6	94.5	61.0	24.8	10.7
179.9	137.5	88.2	68.5	82.9	151.6	39.4	81.0	72.9	86.9
522.5	496.1	445.6	436.8	498.6	441.4	402.4	336.2	297.8	280.3
1,062.3	854.7	788.2	778.8	692.4	584.7	512.8	402.8	385.8	378.7
34.1	33.1	28.2	33.2	28.0	22.6	22.0	23.6	13.8	14.2
1,798.8	1,521.4	1,350.2	1,317.3	1,301.9	1,200.3	976.6	843.6	770.3	760.1
349.0	229.9	211.1	193.1	220.7	230.4	213.3	158.7	134.0	119.3
275.7	313.4	319.6	331.4	262.6	214.6	167.0	175.0	173.9	190.5
73.1	46.1	42.4	40.6	38.6	31.1	13.2	7.9	3.8	1.5
225.4	192.4	169.1	163.1	164.5	140.0	122.9	109.9	102.6	102.1
3.8	4.3	3.7	4.2	3.2	3.0	3.6	3.2	11.2	13.9
75.7	76.2	12.1	12.1	12.1	12.1	12.1	12.1	12.1	12.6
796.1	659.1	592.2	572.8	600.2	569.1	444.5	376.8	332.7	320.2
1,798.8	1,521.4	1,350.2	1,317.3	1,301.9	1,200.3	976.6	843.6	770.3	760.1
205.2	176.8	119.6	87.4	138.8	158.3	155.1	117.6	64.1	51.1
7.8	(25.9)	6.5	48.8	(64.0)	(11.7)	(24.8)	(7.5)	(2.4)	(7.1)
162.9	67.8	3.2	79.7	70.6	120.6	0.3	—	—	48.9
(35.2)	(1.6)	3.2	(16.7)	4.8	15.4	1.9	(12.9)	(4.8)	(9.7)
284.4	132.9	107.7	168.8	164.3	118.3	93.1	41.0	38.0	44.4
16.0	27.3	—	9.2	36.7	14.1	71.8	34.8	20.5	11.8
(39.0)	(17.6)	(13.6)	8.1	(26.7)	4.8	(18.0)	0.2	—	0.7
36.9	25.2	18.7	27.5	44.6	33.3	27.2	13.2	12.4	18.4
42.4	49.3	19.7	(14.4)	(68.7)	112.1	(41.6)	8.0	(14.0)	7.9
2.70	2.34	1.03	(0.15)	1.56	2.71	3.17	2.04	0.83	0.34
0.79	0.60	0.50	0.75	1.00	1.00	0.90	0.55	0.40	0.50
5.17	4.70	3.27	2.41	3.93	4.74	5.21	3.95	2.14	1.71
19.71	17.89	16.20	15.76	16.80	16.31	14.97	12.70	11.22	10.80
23¼	17½	16¼	11	18¾	15⅜	14⅝	12⅜	8¼	13¼
16⅝	14½	9¾	7¾	10	10⅞	11⅛	7	6⅝	6⅞
44.5%	14.5%	56.5%	—	(16.3)%	25.8%	6.9%	70.4%	(0.4)%	(13.6)%
12.3%	13.0%	6.6%	0.9%	8.7 %	18.2%	22.9%	17.1%	7.4 %	3.2 %
24:76	30:70	35:65	36:64	30:70	27:73	27:73	31:69	34:66	36:64
17,706	18,812	16,796	17,571	18,551	20,882	19,995	20,393	22,244	23,330
2,698	2,950	1,175	1,289	1,350	1,415	1,457	1,486	1,537	1,613
40.4	36.8	36.6	36.4	35.8	34.8	29.6	29.6	29.6	29.6
15,295	15,408	15,151	15,017	17,409	18,130	18,353	17,414	16,815	17,520
559.6	537.4	513.0	480.5	473.7	419.2	389.5	337.0	297.3	273.9

Operating locations

Chemicals Group
Head Office:
Etobicoke, Ontario

Specialty Chemicals
Longford (Orillia), Ontario
Dayton, New Jersey

Coal Tar Products
Hamilton, Ontario
Sault Ste. Marie, Ontario

Sifto® Salt
Mines:
Cote Blanche, Louisiana
Goderich, Ontario

Evaporator plants:
Amherst, Nova Scotia
Goderich, Ontario
Unity, Saskatchewan

Processing plant:
Chicago, Illinois

Plus 91 storage depots, warehousing and distribution centres in Canada and the U.S.

Wood Preserving
Truro, Nova Scotia
Newcastle, New Brunswick
Delson, Québec
Trenton, Ontario
Edmonton, Alberta
Cochrane, Alberta
Prince George, British Columbia
New Westminster, British Columbia

Construction Materials Group
Head Office:
Montréal, Québec

Gypsum Products
Windsor, Nova Scotia
Caledonia, Ontario
Winnipeg, Manitoba
Saskatoon, Saskatchewan
Edmonton, Alberta
Surrey, British Columbia

Lockport, New York
Grand Rapids, Michigan
Antioch, California
Long Beach, California
San Leandro, California
Tacoma, Washington

Roofing, Fibreboard and Insulation Products
Donnacona, Québec
Lachine, Québec
Brantford, Ontario
Thorold, Ontario
Lloydminster, Alberta
Burnaby, British Columbia

Laminated Products
LaSalle, Québec
Concord, Ontario
Huntsville, Ontario

Packaging Group
Head Office:
Malton, Ontario

Corrugated Containers
Moncton, New Brunswick
Duberger, Québec
Montréal, Québec
Peterborough, Ontario
Kitchener, Ontario
Toronto, Ontario (3 plants)
St. Marys, Ontario
Winnipeg, Manitoba
Calgary, Alberta
Edmonton, Alberta
Richmond, British Columbia

Composite Cans
(Domtar Sonoco Containers Inc.)

Prescott, Ontario
Mississauga, Ontario
Chatham, Ontario

Containerboard
Trenton, Ontario
Mississauga, Ontario
Red Rock, Ontario

Recycling
Montréal, Québec
Etobicoke, Ontario
Buffalo, New York

Pulp & Paper Products Group
Head Office:
Montréal, Québec

Fine Papers
Windsor, Québec
Beauharnois, Québec
Cornwall, Ontario
Toronto, Ontario
St. Catharines, Ontario

The Fine Papers division also operates a network of fine paper merchants in major metropolitan centres in Atlantic Canada, Québec and Ontario.

Newsprint and Kraft Pulp
Dolbeau, Québec
Donnacona, Québec
Lebel-sur-Quévillon, Québec

Forest Products
Woodlands Districts:
Dolbeau, Québec
South-East Québec
Lebel-sur-Quévillon, Québec
Cornwall, Ontario
Trenton, Ontario
White River, Ontario
Red Rock, Ontario

Sawmills:
Mistassini, Québec
Lebel-sur-Quévillon, Québec
White River, Ontario

Energy Group
Head Office:
Calgary, Alberta

Shareholder and investor information

Annual Meeting
The Annual General Meeting of the shareholders of Domtar Inc. will be held at 11 a.m. on Wednesday, April 29, 1987 in the Château Champlain Hotel, Montréal, Québec.

Transfer Agents and Registrars
For Preference, Series "A" and "B" Preferred Shares and Common Shares: Montreal Trust Company — Halifax, N.S.; Saint John, N.B.; Montréal, Qué.; Toronto, Ont.; Winnipeg, Man.; Regina, Sask.; Calgary, Alta.; Vancouver, B.C.

For Common Shares only: The Bank of New York, New York, N.Y.

Stock Exchanges
Domtar Common, Preference, and Series "A" and "B" Preferred Shares are listed on the Montréal, Toronto and Vancouver Stock Exchanges.

The Common Shares also have trading privileges on the American and Philadelphia Stock Exchanges.

Stock Symbol: DTC

Dividend Option Plans
The following plans are available to shareholders:
— Stock Dividend and Share Purchase Plan
— Dividend Reinvestment and Share Purchase Plan
— U.S. Cash Dividend Plan

Communications about the plans should be addressed to Montreal Trust Company.

Annual Information Form
Shareholders interested in more detailed company information may obtain the Annual Information Form by writing to the Secretary, Domtar Inc.

Investor Relations Contact
Halford M. Wilson, Treasurer
Telephone (514) 848-5860

Domtar Inc.

Head Office:
395 de Maisonneuve Blvd. W.,
Montréal, Québec
H3A 1L6
(514) 848-5400

Trade Marks:
ARBORITE®, CLADBOARD®, DUROID®, FIBRE PLUS®, GYPROC®, PLAINFIELD® and SIFTO® are registered trade marks of Domtar Inc.

CORNWALL COATED CARD™ is a trade mark of Domtar Inc.

Fiberglas(*) is a registered trade mark of Fiberglas Canada Inc. Domtar is an authorized distributor of Fiberglas (*) insulation products in Canada.

Mirastrip(*) is a registered trade mark of American Can Packaging Inc.

Postal Address:
P.O. Box 7210
Station "A"
Montréal, Québec
H3C 3M1

The cover of this Annual Report was lithographed in Canada on Domtar's CORNWALL COATED CARD™, two sides, white, 0.012.

The inside pages were lithographed in Canada on Domtar's CORNWALL COATED CARD™, two sides, white, 0.007, and on PLAINFIELD® OFFSET, Britewhite 160(M) 118 g/m².

Domtar Inc. 1987
Legal Deposit 1st Quarter 1987
Bibliothèque nationale du Québec.

Les actionnaires qui préféreraient recevoir leurs rapports en français voudront bien en aviser le Secrétaire de Domtar Inc.

This short form prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. No securities commission or any similar authority in Canada has in any way passed upon the merits of the securities offered hereunder and any representation to the contrary is an offence. Information has been incorporated by reference in this short form prospectus from documents filed with securities commissions or similar authorities in Canada. Copies of the documents incorporated herein by reference may be obtained on request without charge from your broker or the Secretary of Domtar Inc., 395 de Maisonneuve Blvd. West, Montreal, Quebec H3A 1L6 (telephone (514) 848-5400).

New Issue

AR43

DOMTAR®

Domtar Inc.

$75,000,000
(3,000,000 Shares)

Series B Preferred Shares
(cumulative and redeemable)

Cumulative cash dividends will be payable quarterly on the Series B Preferred Shares on the second day of January, April, July and October in each year in an amount per share determined by applying the Quarterly Dividend Rate to $25.00. The Quarterly Dividend Rate is (i) 2.10% in the case of dividends payable on or prior to April 2, 1991, and (ii) one quarter of 72% of the average of the prime rates of two specified major Canadian chartered banks for specified three-month periods in the case of dividends payable after April 2, 1991.

The Montreal, Toronto and Vancouver stock exchanges have conditionally approved the listing of the Series B Preferred Shares subject to the Corporation fulfilling all the requirements of such exchanges on or before April 30, 1986, including distribution of the Series B Preferred Shares to a minimum number of public holders.

In the opinion of counsel, the Series B Preferred Shares will qualify for investment under certain statutes as set forth under "Eligibility for Investment".

Price: $25 per share to yield initially 8.40%

We, as principals, conditionally offer the Series B Preferred Shares, subject to prior sale, if, as and when issued by the Corporation and accepted by us in accordance with the conditions contained in the Underwriting Agreement referred to under "Plan of Distribution" and subject to the approval of certain legal matters on behalf of the Corporation by Ogilvy, Renault, Montreal and on behalf of the Underwriters by Clarkson, Tétrault, Montreal.

	Price to Public	Underwriters' Fee (1)	Net Proceeds to the Corporation (2)
Per share			
— minimum fee	$25.00	$0.25	$24.75
— maximum fee	$25.00	$0.75	$24.25
Total	$75,000,000	$2,250,000	$72,750,000

(1) The Underwriters' fee per Series B Preferred Share is $0.25 with respect to any such share sold to certain specified institutions prior to the closing of this offering and $0.75 on all other shares. The total represents the Underwriters' fee assuming no Series B Preferred Shares are sold to specified institutions.

(2) Before deduction of expenses of issue estimated at $150,000. These expenses and the Underwriters' fee will each be paid out of the general funds of the Corporation.

Subscriptions will be received subject to rejection or allotment in whole or in part and the right is reserved to close the subscription books at any time without notice. It is expected that the closing of this offering will take place on February 25, 1986 or such other date as may be agreed upon, but not later than March 18, 1986.

BRINK HUDSON & LEFEVER LTD.
SUITE 1500, PARK PLACE
666 BURRARD STREET
VANCOUVER, B.C. V6C 3C4

February 6, 1986

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In this short form prospectus the ''Corporation'' refers to Domtar Inc. and ''Domtar'' refers to the Corporation together with all its subsidiaries.

The Corporation's registered and principal office is at 395 de Maisonneuve Boulevard West, Montreal, Quebec H3A 1L6.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents, filed by the Corporation with the various securities commissions or similar authorities in each of the provinces of Canada, are specifically incorporated by reference and form an integral part of this short form prospectus:

(a) Annual Information Form dated April 24, 1985;

(b) Consolidated Financial Statements for the year ended December 31, 1985 together with the auditors' report thereon;

(c) Management Proxy Circular dated March 18, 1985 in connection with the Corporation's annual meeting of shareholders held on April 24, 1985; and

(d) Management Proxy Circular dated April 24, 1985 in connection with the Corporation's June 3, 1985 special meeting of shareholders called to approve the two-for-one stock split of the Corporation's Common Shares which was effective on June 14, 1985.

Any documents of the type referred to in the preceding paragraph and any material change report (excluding confidential reports) subsequently filed by the Corporation with a securities commission or any similar authority in Canada, after the date of this short form prospectus and prior to the termination of the offering, shall be deemed to be incorporated by reference into this short form prospectus.

Any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this short form prospectus to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this short form prospectus.

ELIGIBILITY FOR INVESTMENT

In the opinion of Ogilvy, Renault and Clarkson, Tétrault, the Series B Preferred Shares offered hereby will, at the date of original delivery, qualify as eligible investments, without resort to the so-called ''basket'' provisions, but subject to general investment provisions, for:

(a) insurance companies registered under the Canadian and British Insurance Companies Act (Canada), the Foreign Insurance Companies Act (Canada) and legislation of Ontario, Alberta, and British Columbia governing insurance companies;

(b) loan companies regulated under the Loan Companies Act (Canada) and legislation of Ontario governing loan companies;

(c) trust companies regulated under the Trust Companies Act (Canada) and legislation of Ontario and British Columbia governing trust companies; and

(d) pension funds regulated under the Pension Benefits Standards Act (Canada) and legislation of Quebec, Ontario and Alberta governing pension funds.

In the opinion of such counsel, the Series B Preferred Shares will, at the date of original delivery, also be qualified investments for registered retirement savings plans, registered retirement income funds and deferred profit sharing plans under the Income Tax Act (Canada).

SUMMARY OF THE OFFERING

Issue: Series B Preferred Shares.

Amount: $75,000,000 (3,000,000 shares).

Price: $25.00 per share to yield initially 8.40%.

Dividends: Cumulative cash dividends will be payable quarterly on the Series B Preferred Shares on the second day of January, April, July and October in each year in an amount per share determined by applying the Quarterly Dividend Rate to $25.00. The Quarterly Dividend Rate is (i) 2.10% in the case of dividends payable on or prior to April 2, 1991, and (ii) one quarter of 72% of the average of the prime rates of two specified major Canadian chartered banks for specified three-month periods in the case of dividends payable after April 2, 1991. Assuming an issue date of February 25, 1986 an initial dividend of $0.73 per share will be payable on July 2, 1986.

Redemption: Not redeemable before April 2, 1991 and redeemable on and after that date at $25.00 per share together with accrued and unpaid dividends.

Purchase Obligation: Purchase on a reasonable efforts basis in each calendar quarter, commencing with the calendar quarter beginning April 2, 1992 at a price not exceeding $25.00 per share plus accrued and unpaid dividends and costs of purchase, 1% of the Series B Preferred Shares outstanding on April 2, 1992.

Rank: The Series B Preferred Shares will rank junior to the Preference Shares (stated capital of $10.7 million as at December 31, 1985), equal to the Series A Preferred Shares and senior to the Common Shares.

Selected Consolidated Financial Information (1)

	Year ended December 31,				
	1985	1984	1983	1982	1981
	(millions of dollars, except per share amounts)				
Sales	$2,129.5	$2,044.3	$1,820.0	$1,686.6	$1,764.7
Net earnings (loss)					
before extraordinary items	96.1	86.1	38.8	5.6	51.1
after extraordinary items	110.4	90.5	38.1	(5.1)	55.3
Cash flow from operations	205.2	176.8	119.6	87.4	138.8
Total assets	1,798.8	1,521.4	1,350.2	1,317.3	1,301.9
Long-term debt	275.7	313.4	319.6	331.4	262.6
Shareholders' equity	871.8	735.3	604.3	584.9	612.3
Per Common Share (2):					
net earnings (loss)					
before extraordinary items	$2.33	$2.22	$1.05	$0.15	$1.44
after extraordinary items	2.70	2.34	1.03	(0.15)	1.56
dividends	0.79	0.60	0.50	0.75	1.00

(1) Certain of the amounts for 1984 and prior years have been restated to reflect a change in the Corporation's accounting policy. Reference is made to "Recent Developments — Change in Accounting Policy".

(2) Adjusted to reflect the two-for-one stock split which was effective June 14, 1985.

This is a summary only and is qualified by the more detailed information appearing elsewhere or incorporated by reference in this short form prospectus.

THE CORPORATION

Domtar is engaged in the manufacture and marketing of a wide range of products through four operating groups: Pulp and Paper Products, Packaging, Chemicals and Construction Materials. In addition, Domtar is engaged in gas and oil exploration and development programs.

The *Pulp and Paper Products Group,* the largest of Domtar's four operating groups, is one of the major pulp and paper manufacturers in Canada. This Group is a vertically integrated business from the harvesting of timber to the marketing of a diverse range of paper products. The Group is the largest producer and marketer of uncoated fine papers in Canada and also produces newsprint, groundwood specialty papers, pulp and lumber.

The operations of the *Packaging Group* are integrated to produce linerboard and corrugating medium for corrugated containers and composite cans. The Group has a major share of the Canadian corrugated container market and is present in all regional markets.

The *Chemicals Group* is a major producer of salt in North America where its Sifto® salt products are widely used for ice control and to a lesser extent for chemical, food processing and general industrial end-uses. The other products of this Group include treated wood, coal tar products and a variety of specialty chemicals.

The *Construction Materials Group* is a leading producer and distributor of construction materials in Canada, gypsum wallboard products in the Pacific region of the United States and masonry products in the south-central region of the United States. The products manufactured include Gyproc® gypsum wallboard, roofing products, Arborite® decorative and industrial laminates, particleboard and Cladboard® products, masonry products and fibreboard products.

Domtar employs approximately 15,300 people and operates 76 mills, mines and plants in Canada and the United States, supported by a network of warehouses and sales offices strategically located across Canada and in certain key areas of the United States. Thirty-two collective labour agreements covering approximately 1,670 employees are subject to renewal during 1986.

Domtar's operations and sales are predominantly in Canada. Sales in the United States from operations in both Canada and the United States represent approximately 31% of its consolidated sales.

Domtar's sales and operating profit (loss) by operating group for the five years ended December 31, 1985 were as follows:

	Year ended December 31,				
	1985	1984	1983	1982	1981
	(millions of dollars)				
Sales					
Pulp and paper products					
Fine papers	$ 538.9	$ 554.2	$ 492.2	$ 466.2	$ 424.3
Newsprint, groundwood specialties, pulp and lumber	350.1	341.8	366.2	368.3	428.9
	889.0	896.0	858.4	834.5	853.2
Packaging	375.4	342.6	290.2	256.2	298.1
Chemicals	286.3	281.9	260.5	269.8	255.6
Construction materials	572.7	518.4	406.0	322.6	354.8
Gas and oil	6.1	5.4	4.9	3.5	3.0
	$2,129.5	$2,044.3	$1,820.0	$1,686.6	$1,764.7
Operating profit (loss)*					
Pulp and paper products	$ 62.1	$ 68.7	$ 52.9	$ 45.2	$ 63.5
Packaging	33.1	37.7	17.5	(3.4)	21.8
Chemicals	23.4	13.7	13.3	24.0	27.2
Construction materials	55.2	36.8	11.5	(26.2)	(9.7)
Gas and oil	1.7	1.8	1.8	(4.1)	(1.8)
	$ 175.5	$ 158.7	$ 97.0	$ 35.5	$ 101.0

*Operating profit (loss) represents sales less allocable operating expenses before corporate expenses, sundry income, interest expense and income taxes. Amounts for 1984 and prior years have been restated to reflect the change in method of accounting for investment tax credits described under "Recent Developments — Change in Accounting Policy".

MANAGEMENT'S DISCUSSION OF 1985 OPERATING RESULTS

Sales in 1985 totalled $2,129.5 million compared to $2,044.3 million for 1984. Operating profit for 1985 was $175.5 million compared to $158.7 million for 1984. Earnings before extraordinary items amounted to $96.1 million or $2.33 per common share, compared to $86.1 million or $2.22 per common share in 1984. Net earnings were $110.4 million or $2.70 per common share, compared to $90.5 million or $2.34 per common share in 1984. The utilization of prior years' tax losses in the United States and the sale of assets resulted in an extraordinary gain being reported in the net amount of $14.3 million in 1985 and $4.4 million in 1984.

In the Pulp and Paper Products Group, operating profit declined compared to 1984. Sales volume was higher in fine papers and lumber, virtually unchanged in newsprint but lower in pulp and in groundwood specialties due to the start-up of new equipment. Profit margins for both the pulp and fine paper businesses declined due to lower selling prices and increased costs as a result of inflation. The newsprint and groundwood specialty papers business had a higher operating profit due to the effect of mid-year 1984 newsprint price increases and the cost benefits derived from the conversion to 100% thermo-mechanical pulping at the mill in Donnacona, Québec. All the Group's businesses benefited from the strong U.S. dollar relative to the Canadian dollar. The results for both periods were adversely affected by an 11 month strike at the Lebel-sur-Quévillon softwood pulp mill which began in June 1984 and was settled in May 1985.

The Packaging Group operating profit declined compared to 1984. The increases in operating costs as a result of inflation more than offset the impact of increased shipments of corrugated containers and the benefit of the mid-year 1984 price increases for corrugated containers and containerboard.

Operating profit of the Chemicals Group increased significantly. Despite a three month strike at the Goderich salt mine, which was settled on September 15, 1985, the Sifto® Salt division reported improved operating profit due to strong weather-related demand for ice control salt and higher selling prices. Lower selling prices for coal tar distillates coupled with a downturn in the demand for these products more than offset higher sales volume and prices for treated wood products. The Lime division, which had operated at a loss, was sold in late 1984.

In the Construction Materials Group operating profit increased significantly over 1984. All of the Group's major businesses generated higher profit margins. The demand for gypsum wallboard in the United States and Eastern Canada continued to be strong. The adverse effect on results of the four month strike at the Caledonia, Ontario gypsum wallboard plant was partially offset by additional sales volume from two gypsum wallboard plants in Western Canada which were acquired in June 1985.

RECENT DEVELOPMENTS

Credit Agreement

On December 19, 1985, the Corporation entered into an agreement with a syndicate of Canadian financial institutions providing for a revolving $500 million (or the U.S. dollar equivalent thereof) line of credit which can be used for general corporate purposes including the Windsor project referred to under ''Capital Expenditures''. This agreement is for a period of 18 months and may be replaced quarterly, by mutual consent, by successive replacement agreements, each for a period of 18 months, the last one of which will expire no later than January 31, 1996. In the event that the lenders decide not to provide a replacement agreement, the Corporation can elect to transfer the line of credit to a subsidiary, provided that such subsidiary acquires the Corporation's fine paper manufacturing facilities at Windsor, Quebec, whereupon the line of credit will be available to such subsidiary until January 31, 1996. The full amount of the line of credit will be available to the Corporation (subject to the entering into of replacement agreements) or such subsidiary (in the event of the transfer thereto of the line of credit) until January 31, 1991 and then at reducing amounts until termination on January 31, 1996.

Change in Accounting Policy

Effective January 1, 1985, the Corporation changed its method of accounting for investment tax credits in accordance with a recommendation by the Canadian Institute of Chartered Accountants. Under the new method, which has been applied retroactively, the benefit of the investment tax credit is deferred and taken into earnings over the life of the related asset. Under the previous method, the benefit was taken into earnings as a reduction of

income tax expense in the period in which the related asset was acquired. The change has had the effect of decreasing net earnings by the following amounts for the periods indicated:

	Year ended December 31,				
	1984	1983	1982	1981	1980
Reduction in net earnings					
Total (millions of dollars)	$3.4	$2.1	$3.5	$7.7	$3.2
Per Common Share*	$0.09	$0.06	$0.10	$0.22	$0.10

*Adjusted to reflect the two-for-one stock split which was effective June 14, 1985.

Stock Split

At a special meeting held June 3, 1985, the shareholders approved a two-for-one stock split of the Common Shares which was effective on June 14, 1985.

Common Share Issues

On June 26, 1985 the Corporation issued and sold 2,400,000 Common Shares with share purchase tax credit to Lévesque, Beaubien Inc., Wood Gundy Inc., Dominion Securities Pitfield Limited and Nesbitt Thomson Bongard Ltée as underwriters in respect of the public distribution of such shares for aggregate net proceeds to the Corporation of $53,773,200. On the same date, the Corporation issued and sold to Dofor Inc. 1,019,500 Common Shares for aggregate proceeds to the Corporation of $18,860,750.

CAPITAL EXPENDITURES

Domtar's capital expenditures for 1985 were $284.4 million. Domtar estimates that its capital expenditures during 1986 will amount to $542 million of which $431 million will relate to the Pulp and Paper Products Group, $40 million to the Packaging Group, $34 million to the Chemicals Group, $33 million to the Construction Materials Group and $4 million to Gas and Oil. The two major items of capital expenditure in 1986 will be the rehabilitation of the fine paper mill at Windsor, Quebec and the thermo-mechanical pulping project at Dolbeau, Quebec.

On April 5, 1985 the Board of Directors of the Corporation gave final approval to the rehabilitation of the fine paper manufacturing facilities at Windsor, Quebec through the establishment of a new fine paper complex. The Corporation has accepted an offer of financial assistance from the federal and Quebec governments in the form of an interest-free loan of $150 million to be received during the period 1985 to 1989 at the rate of $30 million per year, each portion to be repayable 10 years after the respective disbursement dates, together with a grant from the Quebec government of $21.8 million. The Corporation received $14 million of this grant in June 1985 and $7.8 million is due in April 1986. The cost of the fixed assets, including forest land, of the Windsor project is expected to be $870 million (excluding capitalized interest), of which approximately $119 million was spent in 1985 and of which it is estimated $301 million will be spent in 1986.

The Windsor project will include the installation of two high-speed paper machines with annual capacity totalling 317,500 metric tonnes and the construction of a hardwood and softwood pulp mill with an annual combined capacity of 288,000 metric tonnes. The first paper machine and the hardwood pulping operation are projected to begin commercial production by the end of 1987. The second paper machine and the softwood pulping operation are projected to begin commercial production by the end of 1989. Coincident with the start-up phase in the period 1987-1989, existing production facilities at Windsor will be phased out.

The Corporation is also proceeding with an investment of $85 million to convert by mid-1987 the pulping operations at its newsprint mill in Dolbeau, Quebec to the thermo-mechanical process and to add a second production line to the adjacent sawmill. Approximately $7 million was spent in 1985 on this project and $54 million is expected to be spent in 1986.

USE OF PROCEEDS

The estimated $75,000,000 to be received by the Corporation from the sale of the Series B Preferred Shares offered hereby will be used in the Corporation's capital expenditure program described under ''Capital Expenditures'' and pending such use such proceeds will be invested in short-term marketable securities. The expenses of this issue, including the Underwriters' fee, estimated at $2,400,000 will be paid out of the Corporation's general funds.

DIVIDEND COVERAGE

After giving effect to this issue, the aggregate annual dividend requirements on the $1 Cumulative Redeemable Preference Shares (the ''Preference Shares'') and the $2.25 Retractable Preferred Shares Series A (the ''Series A Preferred Shares'') outstanding as at December 31, 1985 and the Series B Preferred Shares would have amounted to $12.6 million. The aggregate annual interest requirements on Domtar's long-term debt outstanding as at December 31, 1985 amount to $35.7 million. The aggregate annual dividend requirements of $12.6 million on the Preference Shares and the Series A Preferred Shares outstanding at December 31, 1985 and the Series B Preferred Shares, grossed-up at an assumed marginal tax rate of 42% would have amounted to $21.7 million. Domtar's consolidated earnings for the twelve months ended December 31, 1985, before deduction of interest on long-term debt, income taxes and minority interest and before extraordinary items amounted to $180.1 million, being approximately 3.1 times the combined long-term debt interest and grossed-up dividend requirements on the Preference Shares, the Series A Preferred Shares and the Series B Preferred Shares of $57.4 million.

The consolidated net earnings of Domtar before extraordinary items for the twelve months ended December 31, 1985 were $96.1 million, being approximately 7.6 times the aggregate annual dividend requirements of $12.6 million.

ASSET COVERAGE

The consolidated net tangible assets of Domtar at December 31, 1985 and after giving effect to this issue, were as follows:

	(millions of dollars)	
Current assets	$ 702.4	
Investments and advances	23.2	
Fixed assets	1,062.3	
Intangible assets and deferred charges	10.9	$1,798.8
Less:		
Current liabilities (excluding long-term debt due within one year)	271.3	
Long-term debt (including long-term debt due within one year)	353.4	
Minority interest	3.8	
Intangible assets and deferred charges	10.9	639.4
		1,159.4
Add:		
Net proceeds from the issue of the Series B Preferred Shares		72.6
Consolidated net tangible assets before deduction of deferred income taxes and deferred credits		1,232.0
Less:		
Deferred income taxes and deferred credits		298.5
Consolidated net tangible assets after deduction of deferred income taxes and deferred credits		$ 933.5

The consolidated net tangible assets of Domtar before and after deduction of deferred income taxes and deferred credits are equivalent to 8.2 times and 6.2 times, respectively, the aggregate stated value of the Preference Shares, Series A Preferred Shares and Series B Preferred Shares to be outstanding after this issue.

The consolidated net tangible assets of Domtar before and after deduction of deferred income taxes and deferred credits (but before the deduction of long-term debt) are equivalent to 3.1 times and 2.6 times, respectively, the sum of the principal amount of such long-term debt and the aggregate stated value of the Preference Shares, the Series A Preferred Shares and the Series B Preferred Shares to be outstanding after this issue.

SHARE CAPITAL OF THE CORPORATION

At December 31, 1985, the authorized share capital of the Corporation consisted of 455,416 Preference Shares, an unlimited number of serial preferred shares, issuable in series (the ''Serial Preferred Shares'') of which the Series A Preferred Shares constitute the first series and the Series B Preferred Shares will constitute the second series and an unlimited number of common shares (the ''Common Shares''). As at the same date, there were 455,416 Preference Shares, 2,600,000 Series A Preferred Shares and 40,399,884 Common Shares outstanding.

Preference Shares

The Preference Shares are entitled to receive fixed cumulative dividends at the rate of $1 per share per annum in preference to the holders of Serial Preferred Shares and Common Shares and rank ahead of the Serial Preferred Shares and Common Shares with respect to return of capital. The Preference Shares have a stated capital of $23.50 per share and are redeemable at $25.00 per share plus accrued and unpaid dividends to the date of redemption.

The Articles of the Corporation provide in effect that no distribution of capital of the Corporation may be made to the holders of any classes of shares of the share capital of the Corporation until the holders of the Preference Shares have been paid the amount of capital paid up thereon plus accrued and unpaid dividends. In the opinion of Ogilvy, Renault, under the present state of the law, any purchase or redemption of Serial Preferred Shares by the Corporation may constitute a distribution of capital. Based on such opinion, unless prior to any such purchase or redemption of Serial Preferred Shares there has been an authoritative restatement of the law in this respect, the Preference Shares outstanding at the time of any such purchase or redemption would have to be redeemed prior thereto or concurrently therewith at $25.00 per share. The Series A Preferred Shares have and the Series B Preferred Shares will have provisions requiring the Corporation to purchase them from time to time. Reference is made to "Discharge by a Third Party of Certain Obligations" as to the possibility of such purchases of Series B Preferred Shares being effected by a person or persons other than the Corporation ("Third Party Purchaser"). The provisions attaching to Series A Preferred Shares similarly provide for the discharge by a Third Party Purchaser of certain of the Corporation's purchase obligations in respect of that series. In the opinion of Ogilvy, Renault such purchases by a Third Party Purchaser would not constitute a distribution of capital.

The Preference Shares do not, subject to the provisions of the Canada Business Corporations Act and except as otherwise expressly stated in the Articles of the Corporation, have any voting rights for the election of directors or for any other purpose unless the Corporation has failed to pay in the aggregate four quarterly instalments of the prescribed dividend.

No dividends may at any time be paid or declared and set apart for payment on the Common Shares or the Serial Preferred Shares unless all accumulated dividends on the Preference Shares have been paid or declared and set apart, including the current quarterly instalment of dividends, nor may the Corporation call for redemption part only of the Preference Shares at a time when dividends have accrued thereon in respect of any period of three months or more and remain unpaid.

Common Shares

The holders of Common Shares are entitled to one vote for each share held of record on all matters voted on by shareholders and, subject to the rights of the holders of Preference Shares and the holders of Serial Preferred Shares, are entitled to receive such dividends as may be declared by the directors out of funds legally available therefor and to receive the remaining property of the Corporation on dissolution. The holders of Common Shares have no preemptive, redemption or conversion rights.

DETAILS OF THE OFFERING

The following is a summary of the material provisions which attach to the Serial Preferred Shares as a class and to the Series B Preferred Shares as a series.

Summary of the Serial Preferred Shares as a Class

The Serial Preferred Shares are issuable in series, each series consisting of such number of shares and having such provisions as may be determined by the Board of Directors of the Corporation prior to the issue thereof. The Serial Preferred Shares as a class have, among others, provisions to the following effect:

Priority

With respect to the payment of dividends and the distribution of assets in the event of the liquidation, dissolution or winding-up of the Corporation, the Serial Preferred Shares rank junior to the Preference Shares but senior to the Common Shares. The Serial Preferred Shares of each series rank equally with the Serial Preferred Shares of every other series with respect to the payment of dividends and distribution of assets.

Dividends

The holders of the Serial Preferred Shares are entitled to receive such dividends payable at such intervals as may be determined in respect of each series.

Voting Rights

The Board of Directors is empowered to set voting rights for each series. The holders of the Serial Preferred Shares are not entitled to any voting rights as a class except as described under ''Modification'' below. When the holders of Serial Preferred Shares vote as a class, each holder shall be entitled to cast, in respect of each such share held, that number of votes equal to the quotient obtained by dividing the aggregate consideration received by the Corporation for the outstanding shares of a series, by the number of outstanding shares of that series, provided that the issue price of any Serial Preferred Shares denominated in currencies other than Canadian shall be converted (for the purpose of such voting rights) into Canadian currency based upon the conversion rate on the date of issue determined to be appropriate by the Board of Directors.

Modification

The class provisions of the Serial Preferred Shares may be amended at any time with such approval as may be required by the Canada Business Corporations Act. The Act currently provides that such approval may be given by at least two-thirds of the votes cast at a meeting of the holders of the Serial Preferred Shares. A quorum for such meeting is the holders of not less than 25% of the outstanding Serial Preferred Shares provided that at any adjourned meeting there is no quorum requirement.

Creation of Shares Ranking Prior to or on a Parity

The Corporation may, without the approval of the holders of the Serial Preferred Shares, create any new class of shares ranking prior to or on a parity with the Serial Preferred Shares. Reference is made to ''Restrictions on Dividends, Retirement and Issue of Shares'' below in respect of the restriction on the issue of such shares.

Certain Provisions of the Series B Preferred Shares as a Series

In addition to the foregoing provisions attached to the Serial Preferred Shares as a class, the Series B Preferred Shares will have attached thereto, among others, provisions to the following effect:

Dividends

Assuming an issue date of February 25, 1986, an initial dividend of $0.73 per share will be payable on July 2, 1986.

After the initial dividend, the holders of the Series B Preferred Shares will be entitled to receive a cumulative cash dividend, as and when declared by the Board of Directors, on the second day of each of January, April, July and October in each year in an amount per share determined by applying the applicable Quarterly Dividend Rate to $25.00. For the purposes hereof, ''Quarterly Dividend Rate'' means (i) 2.10% in the case of dividends payable on or prior to April 2, 1991, and (ii) one quarter of 72% of the average of the Prime Rate in effect on each day during the three calendar months ending immediately prior to the first day of the calendar month preceding the month in which the dividend payment is to be made in the case of dividends payable after April 2, 1991. ''Prime Rate'' means the average of the prime commercial lending rates of interest established and announced from time to time by two specified major Canadian chartered banks as the reference rates of interest per annum to determine the interest rates they will charge on Canadian dollar loans to their most creditworthy customers in Canada. If neither of such banks has a prime rate in effect on any day, the Prime Rate for that day will be 1.50% per annum above the average yield per annum on 91 day Government of Canada Treasury Bills as reported by the Bank of Canada for the weekly tender immediately preceding that day.

Purchase Obligation

So long as any Series B Preferred Shares shall be outstanding, the Corporation will make all reasonable efforts to purchase in each calendar quarter commencing with the calendar quarter beginning April 2, 1992 at a price not exceeding $25.00 per share plus accrued and unpaid dividends thereon and costs of purchase, 1% of the number of the Series B Preferred Shares outstanding on April 2, 1992.

If, notwithstanding the making of all reasonable efforts, the Corporation is unable to fulfill such obligation in any calendar quarter, the obligation will carry over only to the succeeding calendar quarter(s) of the same calendar year and will thereafter be extinguished. The number of Series B Preferred Shares which the Corporation is obligated to purchase during any calendar quarter pursuant to this provision, will be reduced by the number of Series B Preferred Shares, if any, redeemed or purchased by the Corporation in the same calendar quarter otherwise than pursuant to this provision.

The Corporation will not be obligated to purchase any Series B Preferred Shares pursuant to this provision if and so long as such purchase would be contrary to any applicable law or the provisions described under ''Restrictions on Dividends, Retirement and Issue of Shares'' or the corresponding provisions attaching to the Series A Preferred Shares. As discussed under ''Discharge by a Third Party of Certain Obligations'', the Corporation may from time to time, subject to certain conditions, make arrangements for such purchase obligations to be discharged by one or more other persons.

Discharge by a Third Party of Certain Obligations

The Corporation will have the right to make arrangements with one or more persons for the discharge of its obligations described under ''Purchase Obligation'', provided that in the case of Series B Preferred Shares purchased pursuant to the provisions described under ''Purchase Obligation'', the sale by such person or persons of any Series B Preferred Shares so purchased to any purchaser other than the Corporation will increase the Corporation's obligation described under ''Purchase Obligation'' for the calendar quarter following such sale by the number of Series B Preferred Shares equal to the number of such shares so sold and will terminate the right of the Corporation to have one or more other persons discharge its obligation described under ''Purchase Obligation''. Such arrangements, if any, (a) shall not provide that any Series B Preferred Shares so purchased would entitle the holder thereof to any payment by the Corporation other than as provided in the Series B Preferred Share attributes and (b) will not relieve the Corporation of its obligations described under ''Purchase Obligation'' until such time as they have been discharged by such other person or persons.

Redemption

The Series B Preferred Shares will not be redeemable prior to April 2, 1991. Except as noted under ''Restrictions on Dividends, Retirement and Issue of Shares'', the Series B Preferred Shares will be redeemable on and after that date at the option of the Corporation in whole at any time or in part from time to time at $25.00 per share, together with all accrued and unpaid dividends up to the date of redemption, the whole constituting the redemption price.

Notice of any redemption will be given by the Corporation at least 30 days prior to the date fixed for redemption. If less than all of the outstanding Series B Preferred Shares are at any time to be redeemed, the shares to be redeemed will be selected by lot in such manner as the Board of Directors shall by resolution determine or pro rata disregarding fractions.

Purchase for Cancellation

Except as noted under ''Restrictions on Dividends, Retirement and Issue of Shares'', the Corporation will be permitted at any time to purchase for cancellation all or any part of the Series B Preferred Shares on the open market or by invitation for tenders to all holders of Series B Preferred Shares or otherwise at a price per share not exceeding $25.00 plus an amount equal to all accrued and unpaid dividends and costs of purchase.

Rights on Liquidation

Upon any liquidation, dissolution or winding-up of the Corporation, whether voluntary or involuntary, or any other distribution of assets of the Corporation among its shareholders for the purpose of winding up its affairs (hereinafter called ''Liquidation Distribution''), before any payment or distribution to the holders of the Common Shares or any shares ranking junior to the Series B Preferred Shares, the holders of the Series B Preferred Shares shall be entitled to receive the amount of $25.00 per share, together with all accrued and unpaid dividends thereon (which for such purpose shall be calculated as if such dividends, to the extent then unpaid, were accruing for the period from the later of the date of issue and the date of the expiration of the last quarterly period for which dividends thereon were paid in full, up to the date of the Liquidation Distribution).

Restrictions on Dividends, Retirement and Issue of Shares

So long as any of the Series B Preferred Shares are outstanding, unless all of the outstanding Series B Preferred Shares have been called for redemption and the redemption price for the same has been deposited, the Corporation shall not, without the prior approval of the holders of the Series B Preferred Shares, given as described under ''Modification'' below, issue any shares ranking prior to the Series B Preferred Shares.

Unless all accrued and unpaid dividends for previous dividend periods on the Series B Preferred Shares shall have been declared and paid or set apart for payment or all the outstanding Series B Preferred Shares have been called for redemption and the redemption price for same has been deposited, the Corporation shall not, without the prior approval of the holders of the Series B Preferred Shares given as described under ''Modification'' below:

(a) pay any dividends (other than stock dividends) on any shares of the Corporation ranking junior to the Series B Preferred Shares;

(b) except out of the net proceeds of a substantially concurrent issue of shares ranking junior to the Series B Preferred Shares, redeem or purchase or make any capital distribution in respect of any shares of the Corporation ranking junior to the Series B Preferred Shares;

(c) except in connection with the exercise of a retraction privilege or mandatory redemption provision attaching thereto, or except out of the net proceeds of a substantially concurrent issue of shares ranking junior to the Series B Preferred Shares, redeem, purchase or make any capital distribution in respect of any shares of the Corporation ranking on a parity with the Series B Preferred Shares;

(d) except in connection with the conversion of any Serial Preferred Shares into shares of one or more series of such class, issue any Serial Preferred Shares or any shares of any other class ranking on a parity with the Series B Preferred Shares; and

(e) redeem or purchase less than all the Series B Preferred Shares.

Voting Rights

The holders of the Series B Preferred Shares will not be entitled as such to receive notice of or to attend or to vote at any meeting of the shareholders of the Corporation unless dividends on the Series B Preferred Shares are in arrears in an aggregate amount equal to eight quarterly payments. In that event, and so long as any dividends on such shares remain in arrears, the holders of the Series B Preferred Shares will be entitled to receive notice of and to attend, but not to vote at, all meetings of holders of Common Shares and will be entitled, voting separately as a class with all other holders of Serial Preferred Shares who have such right, to elect two Directors of the Corporation.

Modification

The provisions attaching to the Series B Preferred Shares may be amended or varied only with the consent of the holders of the Series B Preferred Shares. Any such consent may be given in writing by all of the holders of the outstanding Series B Preferred Shares or by a resolution passed by at least two-thirds of the votes cast at a meeting or adjourned meeting of the holders of the Series B Preferred Shares called and held for that purpose. The quorum for any such meeting is the holders of not less than 25% of the outstanding Series B Preferred Shares provided that at any adjourned meeting there is no quorum requirement.

PLAN OF DISTRIBUTION

Under an Underwriting Agreement dated January 27, 1986 (the ''Underwriting Agreement'') between the Corporation and Wood Gundy Inc., Lévesque, Beaubien Inc., Dominion Securities Pitfield Limited and Nesbitt Thomson Bongard Ltée (the ''Underwriters''), the Corporation has agreed to sell and the Underwriters have agreed to purchase on February 25, 1986 or such other date as the Corporation and the Underwriters may agree upon but in any event not later than March 18, 1986, all but not less than all the Series B Preferred Shares offered hereby at a price of $25 per share, payable in cash to the Corporation against delivery of the Series B Preferred Shares. The maximum Underwriters' fee payable under the Underwriting Agreement is $2,250,000 for various services relating to the issue and sale of the Series B Preferred Shares which will be paid out of the general corporate funds of the Corporation.

The obligations of the Underwriters under the Underwriting Agreement may be terminated at their discretion on the basis of their assessment of the state of the financial markets and may also be terminated upon the occurrence of certain stated events. However, the Underwriters are obligated to take up and pay for all of the Series B Preferred Shares offered hereby, if any are purchased under the Underwriting Agreement.

In connection with this offering, the Underwriters may over-allot or effect transactions which stabilize or maintain the market price of the Series B Preferred Shares offered hereby at a level above that which might otherwise prevail in the open market. Such transactions, if commenced, may be discontinued at any time.

CERTAIN CANADIAN INCOME TAX CONSIDERATIONS

In the opinion of Ogilvy, Renault and Clarkson, Tétrault, the following is a summary of certain Canadian federal income tax considerations generally applicable on dividends to prospective purchasers of the Series B Preferred Shares who are residents of Canada. The summary takes into consideration the current provisions of the Income Tax Act (Canada) (the ''Tax Act''), the current regulations to the Tax Act and relevant amendments to the Tax Act contained in Bill C-84, taking into account the Notice of Ways and Means Motion to amend the Tax Act presented on December 4, 1985 by the Minister of Finance (the ''Notice of Ways and Means'') to provide for, amongst other matters, a minimum personal income tax, but does not take into account any other changes in law, whether by judicial or legislative action, nor does it take into account provincial income tax legislation or considerations.

This summary is of a general nature only and is not intended to be, nor should it be construed to be, legal or tax advice to any particular purchaser. Therefore, prospective purchasers should consult their own tax advisers with respect to their individual circumstances.

Dividends on the Series B Preferred Shares received by an individual will be included in computing his income, and will be subject to the gross-up and dividend tax credit rules normally applicable to taxable dividends paid by taxable Canadian corporations. The grossed-up amount of such dividends will be included in computing the individual's entitlement to the annual deduction of up to $1,000 for qualifying Canadian source investment income.

Under the Notice of Ways and Means the full grossed-up amount of taxable dividends will be included in the adjusted taxable income for minimum tax purposes and no dividend tax credit will be available to reduce the minimum tax. Generally speaking, a combined federal and provincial tax rate of between 24% and 28% (excluding the federal surtax scheduled to end after the 1986 taxation year), depending upon the province of residence, will be applied to the excess of the adjusted taxable income over a minimum tax exemption of $40,000 plus regular personal exemptions.

Dividends on the Series B Preferred Shares received by a corporation, other than a ''specified financial institution'' (as defined in the Tax Act), will be included in computing its income but normally will also be deductible in computing its taxable income. Dividends on the Series B Preferred Shares received by a specified financial institution will be included in computing its income but will not be deductible in computing its taxable income unless either (i) the specified financial institution did not acquire the Series B Preferred Shares in the ordinary course of the business carried on by such institution or (ii) the Series B Preferred Shares are listed on a prescribed stock exchange in Canada and the specified financial institution, either alone or with persons with whom it does not deal at arm's length, does not receive (or is not deemed to receive pursuant to a designation by a trust of which such institution or person is a beneficiary) in the aggregate dividends in respect of more than 10% of the Series B Preferred Shares outstanding at the time such dividends are received.

AUDITORS, TRANSFER AGENT AND REGISTRAR

The auditors of the Corporation are Price Waterhouse, Chartered Accountants, 1100 Dorchester Boulevard West, Suite 2100, Montreal, Quebec H3B 2G4 and Raymond, Chabot, Martin, Paré, Chartered Accountants, Suite 1900, Tour de la Banque Nationale, Montreal, Quebec H3B 4L8.

Montreal Trust Company, at its principal offices in the cities of Halifax, Saint John, Montreal, Toronto, Winnipeg, Regina, Calgary and Vancouver, will be the transfer agent and the registrar for the Series B Preferred Shares.

PURCHASER'S STATUTORY RIGHTS

Securities legislation in several of the provinces of Canada provides purchasers with the right to withdraw from an agreement to purchase the securities offered hereby within two business days after receipt, or deemed receipt, of this short form prospectus and any amendment. In several of the provinces, securities legislation further provides a purchaser with remedies for rescission or, in certain provinces, damages where the prospectus and any amendment contains a misrepresentation or is not delivered to the purchaser, but such remedies must be exercised by the purchaser within the time limit prescribed by the securities legislation of his province. Purchasers in Saskatchewan, as a term of this offering, are given the same rights of rescission and withdrawal as if it had been necessary to have had a prospectus and any amendment accepted by the Saskatchewan Securities Commission. A purchaser should refer to any applicable provisions of the securities legislation of his province for particulars of these rights or consult with a legal adviser.

Dated: February 6, 1986

CERTIFICATE OF DOMTAR INC.

The foregoing, together with the documents incorporated herein by reference, constitutes full, true and plain disclosure of all material facts relating to the securities offered by this short form prospectus as required by the securities laws of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and New Brunswick and contains no misrepresentation that is likely to affect the value or the market price of the securities to be distributed as required by the Securities Act (Quebec) and regulations thereunder.

(Signed) J. H. SMITH
President and
Chief Executive Officer

(Signed) D. J. SPEIRS
Vice-President,
Finance and Corporate Development
(Chief Financial Officer)

On behalf of the Board of Directors

(Signed) YVES PRATTE
Director

(Signed) J. C. LEBEL
Director

CERTIFICATE OF THE UNDERWRITERS

To the best of our knowledge, information and belief, the foregoing, together with the documents incorporated herein by reference, constitutes full, true and plain disclosure of all material facts relating to the securities offered by this short form prospectus as required by the securities laws of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and New Brunswick and contains no misrepresentation that is likely to affect the value or the market price of the securities to be distributed as required by the Securities Act (Quebec) and regulations thereunder.

WOOD GUNDY INC.

By: (Signed) T. C. W. REID

LÉVESQUE, BEAUBIEN INC.

By: (Signed) JEAN-PIERRE DE MONTIGNY

DOMINION SECURITIES PITFIELD LIMITED

By: (Signed) JEAN-GUY GAUTHIER

NESBITT THOMSON BONGARD LTÉE

By: (Signed) CLAUDE RENY

The following includes the name of every person having an interest either directly or indirectly to the extent of not less than 5% in the capital of:

WOOD GUNDY INC.: wholly-owned by The Wood Gundy Corporation;

LÉVESQUE, BEAUBIEN INC.: André Charron, Pierre Brunet, Paul A. Pommier, H. R. Marleau, Gaston Ostiguy, André D. Godbout, André Lemire, S. E. Brock and A. R. Graham;

DOMINION SECURITIES PITFIELD LIMITED: none; and

NESBITT THOMSON BONGARD LTÉE: J. B. Aune, B. J. Steck, G. R. P. Bongard, K. G. Copland, T. A. Jackson, K. W. McArthur and A. R. D. Nesbitt.

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